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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

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WILLIAM A. MUNDELL  
Chairman

JIM IRVIN  
Commissioner

MARC SPITZER  
Commissioner

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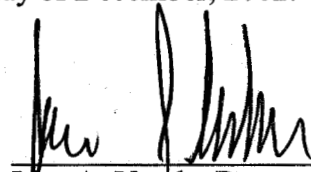
IN THE MATTER OF THE APPLICATION OF  
SOUTHWEST GAS CORPORATION FOR  
APPROVAL OF ACQUISITION PLAN AND, IF  
APPROPRIATE, WAIVER OF SELECTED  
PROVISION OF THE AFFILIATE RULES.

DOCKET NO. G-01551A-02-0425

NOTICE OF FILING STAFF'S  
DIRECT TESTIMONY.

The Utilities Division Staff ("Staff") of the Arizona Corporation Commission ("Commission") hereby files Staff's Direct Testimony in the above referenced matter. This filing includes Direct Testimony for the following witnesses to be called on behalf of Staff: Joel M. Reiker, Robert G. Gray, and Robert E. Miller of the Utilities Division. Since Mr. Reiker's testimony contains confidential information received, pursuant to a protective agreement between Staff and Southwest Gas Corporation ("SWG"), a redacted version of his testimony is being docketed. An unredacted version will be provided to Administrative Law Judge Rodda under seal.

RESPECTFULLY SUBMITTED this 20<sup>th</sup> day of December, 2002.

  
\_\_\_\_\_  
Lisa A. VandenBerg  
Jason D. Gellman  
Attorney, Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007  
(602) 542-3402

Original and thirteen (13) copies of the  
foregoing was filed this 20<sup>th</sup> day of  
December, 2002, with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

1 Copies of the foregoing were mailed  
2 this 20<sup>th</sup> day of December, 2002 to:

3 Andrew W. Bettwy  
4 Southwest Gas Corporation  
5 P.O. Box 89510  
6 Las Vegas, NV 89193-8510  
7 [Unredacted testimony]

8 Edward S. Zub  
9 Southwest Gas Corporation  
10 P.O. Box 89510  
11 Las Vegas, NV 89193-8510  
12 [Unredacted testimony]

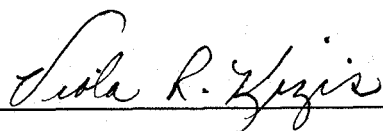
13 John Reiber  
14 Black Mountain Gas Company  
15 P.O. Box 427  
16 Cave Creek, Arizona 85327  
17 [Unredacted testimony]

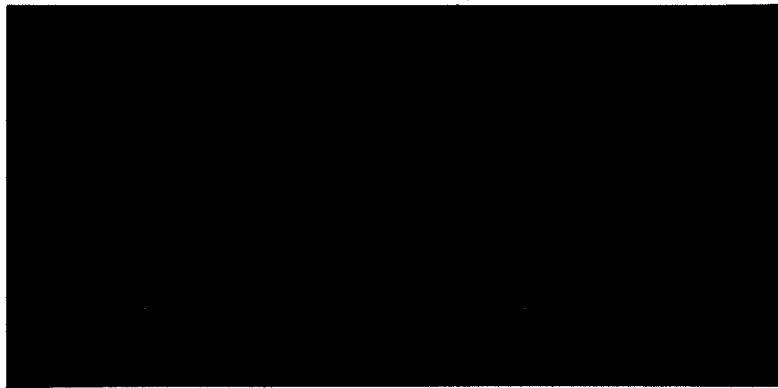
18 Timothy Berg  
19 Theresa Dwyer  
20 Fennemore Craig, P.C.  
21 3003 North Central Avenue, Suite 2600  
22 Phoenix, Arizona 85012  
23 Attorneys for Black Mountain Gas  
24 [Unredacted testimony]

25 Nicholas J. Enoch  
26 Lubin & Enoch, P.C.  
27 349 North Fourth Avenue  
28 Phoenix, Arizona 85003  
Attorneys for IBEW Local 769  
[Redacted testimony]

Scott S. Wakefield, Chief Counsel  
Residential Utility Consumer Office  
1110 West Washington, Suite 220  
Phoenix, Arizona 85007  
[Redacted testimony]

Walter W. Meek  
Arizona Utility Investors Association  
2100 North Central Avenue, Suite 210  
Phoenix, Arizona 85004  
[Redacted testimony]

  
\_\_\_\_\_



**ARIZONA CORPORATION COMMISSION  
UTILITIES DIVISION**

**DIRECT  
TESTIMONY  
OF  
JOEL M. REIKER  
ROBERT G. GRAY  
ROBERT MILLER**

**IN THE MATTER OF THE APPLICATION OF  
SOUTHWEST GAS COMPANY FOR APPROVAL  
OF ACQUISITION PLAN AND, IF APPROPRIATE,  
WAIVER OF SELECTED PROVISIONS OF THE  
AFFILIATE RULES**

**DOCKET NO. G-01551A-02-0425**

**DECEMBER 20, 2002**

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL

Chairman

JIM IRVIN

Commissioner

MARC SPITZER

Commissioner

IN THE MATTER OF THE APPLICATION OF )  
SOUTHWEST GAS COMPANY FOR )  
APPROVAL OF ACQUISITION PLAN AND, IF )  
APPROPRIATE, WAIVER OF SELECTED )  
PROVISIONS OF THE AFFILIATE RULES )  
\_\_\_\_\_ )

DOCKET NO. G-01551A-02-0425

**REDACTED**

DIRECT

TESTIMONY

OF

JOEL M. REIKER

SENIOR PUBLIC UTILITIES ANALYST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

DECEMBER 20, 2002

**EXECUTIVE SUMMARY**  
**SOUTHWEST GAS CORPORATION**  
**DOCKET NO. G-01551A-02-0425**

Southwest Gas Corporation ("SWG") is seeking approval to acquire 100 percent of the stock of Black Mountain Gas Company ("BMG"). SWG also requests authority to subsequently transfer the assets and Certificate of Convenience and Necessity ("CC&N") of BMG to SWG, to consolidate operations.

Under the terms of the agreement between SWG and BMG's current parent, Xcel Energy, Inc. ("Xcel"), SWG will purchase the stock of BMG. Within twelve months of the close of the stock sale, BMG's assets and CC&N will be transferred to SWG, and BMG will be dissolved. SWG ultimately plans to consolidate the rates and operations of BMG's Cave Creek division with its own. SWG intends to sell all of BMG's propane facilities located in Page, Arizona within twelve months of the close of the transaction.

Mr. Reiker provides Staff's analysis of the expected financial impact of the acquisition on BMG. According to Staff's analysis, SWG has at least the same level of financial capability as Xcel. While BMG may not see any significant short-term financial benefits resulting from the acquisition, under SWG it will be shielded from the near-term company-specific risks that Xcel currently faces. In terms of market risk, SWG is riskier than Xcel.

Staff recommends approving SWG's proposed acquisition of BMG's stock and the subsequent transfer of BMG's assets and CC&N to SWG, subject to fourteen conditions. Staff also recommends that the Commission waive compliance with the affiliated interests rules as they may apply to this case.

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1 **INTRODUCTION**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Joel M. Reiker. I am a Senior Public Utilities Analyst employed by the  
4 Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division  
5 ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.  
6

7 **Q. Briefly describe your responsibilities as a Senior Public Utilities Analyst.**

8 A. In my capacity as a Senior Public Utilities Analyst, I provide recommendations to the  
9 Commission on mergers, acquisitions, financings and sales of assets. I also perform  
10 studies to estimate the cost of capital for utilities that are seeking rate relief.  
11

12 **Q. Please describe your educational background and professional experience.**

13 A. In 1998, I graduated cum laude from Arizona State University, receiving a Bachelor of  
14 Science degree in Global Business with a specialization in finance. My course of studies  
15 included classes in corporate and international finance, investments, accounting, and  
16 economics. In 1999, after working as an internal auditor for one year, I was employed by  
17 the Commission as an Auditor III in the Accounting & Rates Section's Financial Analysis  
18 Unit. Since that time, I have attended various seminars and classes on general regulatory  
19 and business issues, including the cost of capital and the use of energy derivatives. I was  
20 promoted to a Senior Rate Analyst in December of 2000.  
21

22 **Purpose of Testimony**

23 **Q. What is the purpose of your testimony in this case?**

24 A. The purpose of my testimony is to provide Staff's recommendations and four of Staff's  
25 conditions regarding approval of Southwest Gas Corporation's ("SWG") Application to



1 Acquire Black Mountain Gas Company ("BMG"). I also present Staff's specific analysis  
2 of the financial impact of the acquisition.

3  
4 **Q. What other Staff witnesses sponsor testimony and what do they address?**

5 A. Mr. Robert G. Gray addresses rates, purchased gas adjustor issues, and gas procurement  
6 activities, and Mr. Robert Miller addresses safety and operational issues.

7  
8 **Q. What is Staff's recommendation in this case?**

9 A. Staff recommends approving SWG's proposed acquisition of BMG's stock and the  
10 subsequent transfer of BMG's assets and CC&N to SWG, subject to fourteen conditions.  
11 Staff also recommends that the Commission waive compliance with the affiliated interests  
12 rules as they may apply to this case.

13  
14 **Southwest Gas Corporation Description**

15 **Q. Please provide a brief description of SWG.**

16 A. SWG is engaged in the business of purchasing, transporting, and distributing natural gas in  
17 portions of Arizona, Nevada and California. SWG is the largest distributor in Arizona,  
18 selling and transporting natural gas in most of central and southern Arizona, including the  
19 Phoenix and Tucson metropolitan areas. According to its December 31, 2001, Form 10-K  
20 filed with the Securities and Exchange Commission ("SEC"), SWG had 785,000  
21 customers in Arizona. SWG is also engaged in the business of construction services. In  
22 2001, SWG had total assets of \$2.3 billion, generated revenues of \$1.4 billion and earned  
23 a net income of \$37 million. SWG's common stock is traded on the New York Stock  
24 Exchange ("NYSE") under the symbol SWX.

1 **Black Mountain Gas Company Description**

2 **Q. Please provide a brief description of BMG.**

3 A. BMG is a wholly owned subsidiary of Xcel Energy, Inc. ("Xcel"), providing natural gas  
4 distribution service and underground propane distribution service to approximately 8,610  
5 customers in Arizona. BMG's Cave Creek division serves approximately 7,260 natural  
6 gas customers in areas in and around Cave Creek, Carefree, Phoenix, and Scottsdale. Its  
7 Page division serves approximately 1,350 customers in the city of Page through  
8 underground distribution of propane vapor. In 2001, BMG had total assets of \$23.5  
9 million, generated revenues of \$9.0 million and earned a net income of \$1.0 million.

10  
11 **Xcel Energy, Inc. Description**

12 Xcel, a Minnesota corporation, is a registered holding company which owns six utility  
13 subsidiaries that serve electric and natural gas customers in 12 states including Arizona,  
14 Colorado, Kansas, Michigan, Minnesota, New Mexico, North Dakota, Oklahoma, South  
15 Dakota, Texas, Wisconsin and Wyoming. Xcel also owns or has an interest in a number  
16 of nonregulated businesses, the largest of which is NRG Energy, Inc. ("NRG"), a publicly  
17 traded independent power producer. In 2001, Xcel had total assets of \$28.7 billion,  
18 generated revenues of \$15.0 billion and earned a net income of \$790 million. Xcel's  
19 common stock is traded on the NYSE under the symbol XEL.

20  
21 **The Proposed Transaction**

22 **Q. Please describe the proposed acquisition.**

23 A. Under the terms of the agreement ("Agreement") between SWG and BMG's parent, Xcel,  
24 SWG will purchase all the common shares of BMG. The filing contemplates that within  
25 twelve months of the close of the stock sale, BMG's assets and certificate of convenience

1 and necessity ("CC&N") will be transferred to SWG, and BMG will be dissolved as a  
2 corporation.

3  
4 **Q. Why is SWG requesting Commission approval of its acquisition of BMG?**

5 A. According to Arizona Revised Statute ("A.R.S.") § 40-285(D), "A public service  
6 corporation shall not purchase, acquire, take or hold any part of the capital stock of any  
7 other public service corporation organized or existing under the laws of this state without  
8 a permit from the Commission."

9  
10 For a period of time (not more than twelve months) after the purchase of BMG's stock by  
11 SWG, BMG will exist as a wholly owned subsidiary of SWG. BMG will then transfer its  
12 assets and CC&N to SWG. Asset transfers are subject to Commission jurisdiction  
13 pursuant to A.R.S. § 40-285(A), which says, "A public service corporation shall not sell,  
14 lease, assign, mortgage or otherwise dispose of or encumber the whole or any part of its  
15 ... system necessary or useful in the performance of its duties to the public, or any  
16 franchise or permit or any right thereunder, nor shall such corporation merge such system  
17 or any part thereof with any other public service corporation without first having secured  
18 from the commission an order authorizing it so to do." Because BMG will exist as a  
19 wholly owned subsidiary of SWG for a period of time, this may constitute the  
20 reorganization of a public utility holding company as defined in Arizona Administrative  
21 Code ("A.A.C.") R14-2-801. Therefore, Staff believes that Commission approval under,  
22 or waiver of, the Public Utility Holding Companies and Affiliated Interests rules  
23 ("affiliated interests rules") is also required.

24  
25 **Q. Please summarize the various approvals and/or relief being sought by SWG.**

1 A. SWG is seeking the following approvals and/or relief in connection with its acquisition of  
2 Black Mountain:

- 3 1. Approval of SWG's acquisition of BMG's common stock pursuant to A.R.S. §  
4 40-285(D).
- 5 2. Approval of the transfer of the assets and CC&N of BMG to SWG pursuant to  
6 A.R.S. § 40-285(A) and A.R.S. § 40-281.<sup>1</sup>
- 7 3. Approval of the reorganization of a public utility holding company pursuant to  
8 A.A.C. R14-2-801 et seq., or alternatively, a waiver of A.A.C. R14-2-801 et  
9 seq.

10  
11 **Q. What are SWG's long-term plans for BMG?**

12 A. According to the filing, SWG plans to sell all of BMG's propane facilities located in Page,  
13 Arizona and dissolve BMG as a corporate entity within twelve months of the close of this  
14 transaction. SWG plans to absorb (or incorporate) BMG's current Cave Creek division's  
15 natural gas operations as part of the Southwest Gas Corporation. Both are local natural  
16 gas distribution operations.

17  
18 **Q. Has SWG solicited any prospective buyers for the Page division?**

19 A. No. SWG is restricted by the agreement from soliciting any prospective buyers for the  
20 Page propane operations prior to the close of the transaction. However, an initiative  
21 which would have given the city of Page permission to purchase these assets appeared on  
22 the City of Page's November 5<sup>th</sup> ballot. According to the November 6, 2002, edition of  
23 the Lake Powell Chronicle, the initiative failed 45 percent to 55 percent. Staff is currently  
24 unaware of any other parties interested in acquiring the Page division.

25  


---

<sup>1</sup> A.R.S. § 40-281 refers to the "extension" of plant, service, or system by a public service corporation.

1 **Q. What is the purchase price for BMG's Stock?**

2 A.  2

6  
7 **Q. What is the book value of the assets to be sold to SWG?**

8 A. According to SWG's responses to data requests, the net book value of the assets to be sold  
9 to SWG is  as of December 31, 2001.

10  
11 **Q. What is the size of the expected acquisition adjustment related to the acquisition?**

12 A. In responding to RUCO data request RUCO 1-2(B), SWG did not provide an estimate of  
13 the expected acquisition adjustment. Instead, SWG stated the following with regard to the  
14 premium paid:

15  
16  
17  
18  
19  
20  
21  
22  
23  
24 SWG further stated in response to RUCO 1-2(C):

25  
26  
27  
28  
29  
30 I will address the acquisition adjustment and its effects again later in this testimony.

<sup>2</sup> Please note that this report contains information that SWG has classified "Confidential" under the terms of a Protective Agreement that SWG and Staff entered into and docketed on August 23<sup>rd</sup>, 2002. Such currently considered "Confidential" information has been redacted in the docketed version of this report and appears in the unredacted version in italics.

1  
2 **Q. How does SWG plan to finance the purchase?**

3 A. SWG has stated that it will use its available cash for the acquisition of BMG. According  
4 to its December 31, 2001, form 10-K on file with the SEC, SWG had cash and cash  
5 equivalents of \$32.5 million.  
6

7 **FINANCIAL ANALYSIS**

8 **SWG's Financial Capability**

9 **Q. Why is it necessary to examine SWG's financial capability?**

10 A. SWG's financial capability should be examined and compared to that of BMG's current  
11 parent, Xcel. If SWG is not capable of providing at least the same level of financial  
12 support as that currently provided by Xcel, then the acquisition may not be in the public  
13 interest. The Commission should find SWG to be a fit and proper entity financially, to  
14 acquire BMG's CC&N before authorizing the sale. SWG's financial capability is an  
15 integral part of that determination.  
16

17 **Q. How does the financial community view SWG?**

18 A. Generally, the financial community regards SWG as a fast-growing utility that keeps pace  
19 with its cash requirements through regular requests for rate relief. The September 20,  
20 2002, edition of The Value Line Investment Survey ("Value Line") stated the following:  
21

22 The company's earnings are benefiting from rate relief. Rate  
23 increases in Arizona and Nevada added about \$10 million to  
24 second-quarter operating margin, which led to a historically  
25 normal \$0.35 share loss. Strong customer growth, which is  
26 averaging about 4% annually, added an additional \$5 million to  
27 operating margin. But this was essentially offset by the effects of  
28 extremely warm weather in April. Also, though expenses are  
29 tightening up, [SWG] continues to tread water when it comes to  
30 funding the rapid pace of its expansion. To that end, a pending  
31 rate case in California appears pivotal to earnings growth. [SWG]

1 is seeking \$23.5 million over 5 years to recover costs associated  
2 with customer growth and pipeline replacement. The California  
3 Public Utility Commission is expected to announce a ruling by the  
4 end of the year, with rate relief possibly becoming effective in  
5 2003.

6 Value Line ranks SWG's financial strength at "B". Financial strength is a relative  
7 measure of the financial strength of the 1,700-plus companies reviewed by Value Line.  
8 The relative ratings range from "A++" (strongest) down to "C" (weakest) in nine steps.  
9

10 **Q. How does Value Line rank BMG's current parent Xcel?**

11 A. In recent months, Value Line has lowered Xcel's financial strength rating two notches  
12 from "B+" to "C++". This lowering was mainly due to cash problems caused by its  
13 unregulated subsidiary NRG, which like many power-marketing companies has faced  
14 severe pressures due to low power prices and a heavy debt burden. In its August and  
15 November reports, Value Line recommends that its subscribers avoid purchasing Xcel's  
16 stock.  
17

18 As of the date this testimony was filed, Xcel cut its quarterly dividend in half, wrote off its  
19 \$2.9 billion investment in NRG, and received a waiver from the SEC allowing its equity  
20 ratio to fall below 30 percent of total capitalization. However, in spite of the financial  
21 problems caused by its unregulated activities, Value Line states in its November report  
22 that Xcel's utility operations currently remain healthy, generating more than enough cash  
23 to cover their capital spending needs.  
24

25 **Market Risk Comparison**

26 **Q. Is SWG riskier than Xcel in terms of market risk?**

1 A. Yes. Market risk is commonly measured by the capital asset pricing model beta.<sup>3</sup> The  
2 higher the beta, the higher the risk of the company's stock, and all other things held equal,  
3 the higher its cost of equity. According to the November 29<sup>th</sup>, 2002, edition of Value  
4 Line, Xcel's beta is .60. SWG's beta is .70. Therefore, according to standard corporate  
5 finance principles, BMG will be acquired by a company whose common equity is riskier  
6 than BMG's current parent in terms of market risk.  
7

8 **Financial Impact on BMG**

9 **Q. What financial effect does Staff anticipate the acquisition will have on BMG in the**  
10 **short term?**

11 A. Staff anticipates that the acquisition will have little to no financial effect on BMG in the  
12 short term. However, if Xcel's financial strength and ultimately its bond rating were to  
13 continue to deteriorate in the near term, this could have negative implications for BMG if  
14 it were to remain an Xcel subsidiary.  
15

16 Both Moody's Investors Service ("Moody's") and Standard and Poor's ("S&P") rank  
17 SWG's and Xcel's debt as adequate/medium grade. On September 5, 2002, Moody's  
18 lowered Xcel's corporate debt rating one notch, from Baa2 to Baa3, with an outlook for  
19 possible further downgrades. S&P ranks Xcel one notch higher than SWG, and SWG  
20 remains on "negative outlook" due to high leverage, lagging regulatory recovery, and  
21 elevated capital expenditures due to customer growth (see Table 1).  
22

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<sup>3</sup> Market risk, also known as systematic risk, is the risk related to economy-wide perils that threaten all businesses such as changes in interest rates, inflation, and general business cycles. Market risk cannot be avoided regardless of how diversified a portfolio is and it is the only type of risk that affects the cost of equity.



**Table 1<sup>4</sup>**

	SWG	Xcel
Moody's	Baa2	Baa3 (neg outlook)
Standard & Poors	BBB- (neg outlook)	BBB

Based on the above analysis, BMG may not see a substantial increase in its access to capital due to its acquisition by SWG. However, the proposed transaction would prevent BMG from being exposed to the possible worsening financial condition of Xcel in the near term.

**Q. Is Staff able to quantify the long-term financial effect the acquisition will have on BMG?**

A. No. The long-term financial effect the acquisition will have on BMG is uncertain because the risk profiles of utility holding companies are ever-changing. Under SWG, BMG will be part of a utility whose regulated operations accounted for 85 percent of its revenues in 2001. In contrast, Xcel's regulated utility operations accounted for only 66 percent of total revenues in 2001. Xcel's recent write off of NRG, however, may signal a long-term shift back to core regulated utility operations.

**Q. What are SWG's long-term diversification plans?**

A. According to a response to a Staff data request, SWG's business strategy "is to focus on its local natural gas distribution business and evaluate and pursue sensible strategic opportunities as they may arise."

**Q. What is Staff's overall assessment of the financial impact of the acquisition on BMG?**

<sup>4</sup> See Exhibit JMR-1 for descriptions of bond ratings.

1 A. SWG has at least the same level of financial capability as Xcel. While BMG may not see  
2 any significant short-term financial benefits resulting from the acquisition, under SWG it  
3 will be shielded from the near-term company-specific risks that Xcel currently faces. In  
4 terms of market risk, SWG is riskier than Xcel.

5  
6 **The Acquisition Adjustment**

7 **Q. How does SWG propose to treat the acquisition adjustment in this case?**

8 A. In response to RUCO data request RUCO 1-2(D), SWG stated:

9  
10 [REDACTED]  
11 [REDACTED]  
12 [REDACTED]  
13 [REDACTED]  
14 [REDACTED]  
15 [REDACTED]  
16 [REDACTED]  
17 [REDACTED]  
18 [REDACTED]  
19 [REDACTED]  
20 [REDACTED]

21  
22 **Q. Do you agree** [REDACTED]

23 [REDACTED]  
24 [REDACTED] ?

25 A. Yes. However, I also believe that because [REDACTED]

26 [REDACTED] it is appropriate to address the  
27 ratemaking treatment of the acquisition adjustment in this proceeding. Addressing any  
28 potential ratemaking treatment of the acquisition adjustment in this proceeding benefits  
29 the Company and ratepayers by reducing uncertainty regarding future rates.  
30

1 **Q. What is Staff's recommendation regarding any future ratemaking treatment of the**  
2 **acquisition adjustment?**

3 A. Staff recommends a condition that prohibits SWG from seeking recovery of any  
4 acquisition adjustment. The amount to which a utility is entitled to a fair return is the cost  
5 incurred for the public benefit. The public benefit is not tied to the amount paid. The cost  
6 incurred by the first utility to devote plant to public service is the cost known to benefit the  
7 public. Further, the proposed acquisition does not involve a severely distressed company  
8 being acquired for the sole purpose of improving such things as service and safety for the  
9 public benefit.

10  
11 **Access to Information**

12 **Q. What does Staff conclude about its ability to obtain information from SWG versus**  
13 **BMG/Xcel?**

14 A. Staff concludes that there will likely be no change in its access to information from SWG  
15 versus BMG/Xcel. While much of the information requested from BMG in this and in  
16 recent dockets was provided by Xcel corporate personnel located in Minnesota, Staff has  
17 experienced few difficulties in obtaining such information. Likewise, with the exception  
18 of receiving late responses to some data requests in this docket, Staff has experienced few  
19 difficulties in obtaining information from SWG at the local and corporate levels.

20  
21 **CONSUMER SERVICES ANALYSIS**

22 **Q. Has Staff reviewed the complaint history of SWG versus BMG/Xcel?**

23 A. Yes. Staff's Consumer Services section provided information detailing the complaint  
24 history of SWG and BMG while under Xcel, from 2000 through the filing of this  
25 testimony. According to the data, the number of complaints per 10,000 customers for this  
26 approximately three-year period is one for SWG and eight for BMG.

**CONCLUSIONS AND RECOMENDATIONS**

**Q. What is Staff's function regarding its decision whether to recommend approval SWG's acquisition of BMG?**

A. Staff believes that the Commission should find any such acquisition to be in the public interest before approving an application. In examining the question of "public interest," Staff believes the Commission should look for public interest in the acquisition of the stock, the subsequent transfer of assets, the transfer of the CC&N, and in any direct consumer benefits. In Staff's opinion, the acquisition, as proposed, offers no obvious and significant immediate consumer benefit.

**Q. What is Staff's conclusion whether the proposed acquisition is in the public interest?**

A. Staff concludes that SWG's proposed acquisition of BMG's stock and the subsequent transfer of the assets and CC&N of BMG to SWG as proposed, is not obviously in the public interest without conditions. The transaction could be consistent with the public interest provided the Commission adopts the conditions set forth below; in particular condition 5, which provides an obvious and significant direct benefit to ratepayers. Furthermore, Staff concludes that when BMG is dissolved as a corporate entity, SWG would be a fit and proper entity to receive the CC&N previously granted to BMG.

**Q. What is staff's recommendation regarding the affiliated interests rules?**

A. Staff recommends that, with the adoption of Staff's conditions, the Commission waive compliance with the affiliated interests rules in this case. A.A.C. R14-2-806(A) reads, "The Commission may waive compliance with any of the provisions of this Article upon a finding that such waiver is in the public interest." With conditions, Staff believes a waiver is in the public interest. SWG represents that BMG will be dissolved within twelve

1 months of the stock purchase (and its operations will be merged into SWG's). Therefore,  
2 the reorganization of a public utility holding company is incidental in the overall  
3 transaction.

4  
5 **Q. What are Staff's recommendations?**

6 A. Staff recommends approving SWG's proposed acquisition of BMG's stock and  
7 subsequent transfer of BMG's assets and CC&N to SWG, and waiving compliance with  
8 the affiliated interests rules, subject to the following conditions:

- 9
- 10 1. SWG shall not seek future rate recovery of any acquisition adjustment related to the  
11 acquisition.
  - 12
  - 13 2. SWG shall not seek recovery of any costs associated with the acquisition, including  
14 internal corporate costs, in any future Arizona rate proceeding.
  - 15
  - 16 3. SWG shall not allow the quality of service in either the current SWG or BMG service  
17 territories to diminish as a result of the acquisition. The number of service complaints  
18 should not increase, the response time to service complaints should not increase, and  
19 service interruptions should not increase.
  - 20
  - 21 4. SWG shall not use any utility plant or other property, that is used or necessary for the  
22 provision of utility service, for any unregulated activity unless SWG maintains  
23 appropriate books and records of account detailing the nature of such unregulated  
24 activity and providing appropriate allocations between activities relating to SWG's  
25 provision of utility service and the unregulated activity. SWG's books and records  
26 concerning all unregulated activities shall be subject to the Commission's review and

1 shall be made available in the Phoenix metropolitan area or, at the Commission's  
2 request, where the records are maintained, on ten days notice.

3  
4 5. BMG shall dissolve as a corporate entity on or before July 1, 2004. At the completion  
5 of the dissolution, BMG shall file a notice within this docket attesting to the specific  
6 date that the BMG dissolution was completed (herein referred to as the "noticed date").  
7 Upon the noticed date of dissolution, the transfer of BMG's CC&N to SWG shall be  
8 deemed effective. As well, SWG's authorized natural gas rates and charges in their  
9 entirety shall be deemed the authorized rates and charges for Cave Creek division  
10 customers' effective the noticed date of BMG's dissolution. If BMG fails to complete  
11 dissolution by July 1, 2004, as discussed above, BMG shall file a sufficient rate  
12 application with the Arizona Corporation Commission on or before July 1, 2004.  
13 Please note that this condition shall not limit Staff's ability to initiate a rate case at any  
14 time. Furthermore, in no case shall the currently authorized BMG rates and charges  
15 remain in effect beyond July 1, 2004, without BMG initiating a sufficient rate  
16 application with the Commission.

17  
18 6. The Cave Creek Division PGA mechanism shall be merged with Southwest's PGA  
19 mechanism on the date of Black Mountain's completed dissolution.

20  
21 7. If SWG fails to sell BMG's Page Propane Division at or prior to the perfected  
22 dissolution of BMG, SWG shall take all appropriate and timely steps to ensure rates  
23 and charges are in place for the current BMG propane customers, such as: SWG filing  
24 a request to charge BMG's existing rates, or SWG filing a report amending SWG's  
25 filing in this case clarifying that BMG as a corporate entity would remain intact for the

1           sole purpose of providing the same propane service as BMG's Page Division currently  
2           provides in its propane operations.

3  
4           8. If SWG fails to file for Commission approval of the sale of BMG's Page Division  
5           within 18 months of the Commission's approval of SWG's acquisition of BMG, the  
6           Page Division should within 19 months of a decision in this case make a filing for  
7           Commission approval to begin offering the Page Division propane customers service  
8           options that are currently available to SWG's customers. Such services include, but  
9           are not limited to, a low income discount tariff for residential customers, a balanced  
10          payment plan option, an online bill payment option, and applicable demand-side  
11          management programs.

12  
13          9. SWG shall continue to maintain the existing emergency isolation valves in all current  
14          BMG service areas.

15  
16          10. During the 2002 Code Compliance Audit, BMG stated that it was installing additional  
17          emergency isolation valves (approximately 34). If at the time of the Stock transfer  
18          from Xcel to SWG, BMG has not completed the installation of all currently planned  
19          valves for the Cave Creek Division, SWG shall complete the installation of those said  
20          valves no later than May 1, 2003.

21  
22          11. SWG shall not allow the acquisition to diminish staffing that would result in service  
23          and/or safety degradation in either the current SWG or BMG service territories.

24  
25          12. SWG shall continue to maintain fully operational local field offices in the cities of  
26          Cave Creek and Page, as appropriate, to maintain the quality of service.

1  
2 13. SWG shall continue BMG's current policy of not using contract personnel for the  
3 performance of underground pipeline locating.  
4

5 14. SWG or BMG shall complete all mapping of the BMG pipeline system no later than  
6 May 1, 2003, as agreed to by BMG during its 2002 Code Compliance Audit.  
7

8 **Q. Which Staff witnesses are sponsoring these conditions?**

9 A. I am sponsoring conditions 1 through 4. Mr. Robert G. Gray is sponsoring conditions 5  
10 through 8. Mr. Robert Miller is sponsoring conditions 9 through 14.  
11

12 **Q. How could SWG have demonstrated an obvious and significant immediate consumer**  
13 **benefit in its application?**

14 A. SWG could have proposed applying SWG's existing tariffs to BMG's Cave Creek  
15 division upon the stock transfer. The rates issue is further discussed in the direct  
16 testimony of Robert G. Gray.  
17

18 **Q. Does this conclude your direct testimony?**

19 A. Yes, it does.



**Standard & Poors Corporation Bond Ratings**

AAA	Highest
AA	Very strong capacity to pay interest and repay principal.
A	Strong capacity to pay interest and repay principal.
BBB	Adequate capacity to pay interest and repay principal.
BB	Faces major ongoing uncertainties...which could lead to inadequate capacity to meet timely interest and principal payments.
B	Vulnerability to default but currently has the capacity to meet interest payments and principal repayments.
CCC	Currently identifiable vulnerability to default.
CC	Subordinated to CCC debt.
C	Subordinated to CCC- - debt.
CI	Income bonds on which no interest is being paid.
D	In default.

Plus (+)/Minus (-) The ratings from 'AA' to 'B' may be modified by the addition of a plus or minus sign to show relative standing within the major ratings categories.

**Moody's Investors Service, Inc. Bond Ratings**

Aaa	Judged to be of the best quality.
Aa	Judged to be of high quality by all standards.
A	Possess many favorable investment attributes and are to be considered as upper medium grade obligations.
Baa	Considered as medium grade obligations.
Ba	Judged to have speculative elements.
B	Generally lack characteristics of the desirable investment.
Caa	Are of poor standing.
Ca	Speculative in a high degree.
C	Lowest rated class of bonds.

Moody's applies numerical modifiers 1, 2, and 3 in each generic rating classification from Aa through B. The modifier 1 indicates that the company ranks in the higher end of its generic rating category.

**Fitch Investors Service, Inc. Bond Ratings**

AAA	Bonds considered to be investment grade and of the highest quality.
AA	Bonds considered to be investment grade and of very high credit quality.
A	Bonds considered to be investment grade and of high credit quality.
BBB	Bonds considered to be investment grade and of satisfactory credit quality.
BB	Bonds are considered speculative.
B	Bonds are considered highly speculative.
CCC	Bonds have certain identifiable characteristics which, if not remedied, may lead to default.
CC	Bonds are minimally protected.
C	Bonds are in imminent default.
DDD, DD, and D	Bonds are in default on interest and/or principal payments.

Plus (+)/Minus (-) Plus and minus signs are used with a rating symbol to indicate the relative position of a credit within the rating category.

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL

Chairman

JIM IRVIN

Commissioner

MARC SPITZER

Commissioner

IN THE MATTER OF THE APPLICATION OF )  
SOUTHWEST GAS CORPORATION - FILING )  
FOR APPROVAL OF ACQUISITION PLAN )  
AND, WAIVER OF SELECTED PROVISIONS )  
OF THE AFFILIATE RULES )  

---

DOCKET NO. G-01551A-02-0425

DIRECT

TESTIMONY

OF

ROBERT G. GRAY

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

DECEMBER 20, 2002

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**EXECUTIVE SUMMARY**  
**SOUTHWEST GAS CORPORATION**  
**DOCKET NO. G-01551A-02-0425**

The following recommendations were prepared in response to Southwest Gas Corporation's ("SWG" and/or "Southwest") Application requesting approval of SWG's proposed acquisition of Black Mountain Gas Company ("BMG" and/or "Black Mountain"). Staff's recommendations are as follows for the Cave Creek Division:

1. BMG shall dissolve as a corporate entity on or before July 1, 2004. At the completion of the dissolution, BMG shall file a notice within this docket attesting to the specific date that the BMG dissolution was completed (herein referred to as the "noticed date").

Upon the noticed date of dissolution, the transfer of BMG's CC&N to SWG shall be deemed effective. As well, SWG's authorized natural gas rates and charges in their entirety shall be deemed the authorized rates and charges for Cave Creek Division customers' effective the noticed date of BMG's dissolution.

If BMG fails to complete dissolution by July 1, 2004, as discussed in above, BMG shall file a sufficient rate application with the Arizona Corporation Commission ("Commission" or "ACC") on or before July 1, 2004. Please note, this condition shall not limit Staff's ability to initiate a rate case at anytime.

Furthermore, in no case shall the currently authorized BMG rates and charges remain in effect beyond July 1, 2004, without BMG initiating a sufficient rate application with the Commission.

2. The Cave Creek Division PGA mechanism shall be merged with Southwest's PGA mechanism on the date of Black Mountain's completed dissolution.

Staff's recommendations are as follows for the Page Division:

1. If SWG fails to sell BMG's Page Propane Division at or prior to the noticed date of BMG's dissolution, SWG shall take all appropriate and timely steps to ensure rates and charges are in place for the current BMG propane customers, such as: SWG filing a request to charge BMG's existing rates, or SWG filing a report amending SWG's filing in this case clarifying that BMG as a corporate entity would remain intact for the sole purpose of providing the same propane service as BMG's Page Division currently provides in its propane operations.

2. If SWG fails to file for Commission approval of the sale of BMG's Page Division within 18 months of the Commission's approval of SWG's acquisition of BMG, the Page Division should within 19 months of a decision in this case make a filing for Commission approval to begin offering the Page Division propane customers service options that are currently available to SWG's customers. Such services include, but are not limited to, a low income discount tariff for residential customers, a balanced payment plan option, an online bill payment option, and applicable demand-side management programs.

1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Robert Gray. My business address is 1200 West Washington, Phoenix,  
4 Arizona 85007.

5  
6 **Q. By whom are you employed and in what capacity?**

7 A. I am employed by the Utilities Division of the Arizona Corporation Commission  
8 ("Commission") as a Senior Economist. My duties include the evaluation of natural gas  
9 and electric industry issues and formulation of Staff recommendations to the Commission.  
10 A copy of my resume is provided in Exhibit RG-1.

11  
12 **Q. As part of your employment responsibilities, were you assigned to review matters**  
13 **contained in Docket No. G-01551A-02-0425?**

14 A. Yes.

15  
16 **Q. What is the purpose of your testimony?**

17 A. My testimony will present the Utilities Division Staff's ("Staff") position related to the  
18 acquisition of Black Mountain Gas ("Black Mountain") by Southwest Gas ("Southwest")  
19 with regard to the rates to be paid by current Black Mountain customers as a result of the  
20 acquisition. purchased gas adjustor issues, gas procurement issues, and other  
21 rates/services.

22  
23 **CAVE CREEK DIVISION**

24 **IMPACT OF ACQUISITION ON CUSTOMER RATES**

25 **Q. Please describe Black Mountain's Cave Creek Division.**

26 A. The Cave Creek Division is located in the northeastern section of the Phoenix

1 metropolitan area and is served with natural gas. As of the monthly Purchased Gas  
2 Adjustor ("PGA") report filed at the end of October, 2002, the Cave Creek Division serves  
3 7,560 residential customers and 211 commercial customers, with sales of 6,179,732  
4 therms from October 2001 through September 2002. The Cave Creek Division receives  
5 its natural gas supplies from two sources, Southwest (through Southwest's Schedule G-95)  
6 and the El Paso Natural Gas Company ("El Paso") pipeline system under Black  
7 Mountain's FT-2 full requirements contract with El Paso.

8  
9 **Q. Has Southwest made any proposals regarding the treatment of rates paid by Black**  
10 **Mountain's Cave Creek Division customers as a result of the acquisition?**

11 A. Yes. In Southwest's application for approval of the acquisition, Southwest proposes to  
12 retain the current margin rates for Cave Creek Division customers until the next Southwest  
13 general rate proceeding, at which time Southwest anticipates that former Black Mountain  
14 customers would begin paying the same rates as other Southwest customers. With the  
15 exception of the existing Cave Creek Division margin rates, Southwest has further  
16 proposed to apply all of its charges, terms, and conditions of service to Cave Creek  
17 Division customers after the acquisition is completed.

18  
19 **Q. Does Staff agree with Southwest's recommendation that the current Black Mountain**  
20 **margins for the Cave Creek Division be retained until Southwest's next rate**  
21 **proceeding?**

22 A. No. Currently Southwest generally has smaller margins in its current tariffed rates than  
23 Black Mountain does. For example, a comparison of the existing residential tariffs shows  
24 that Black Mountain's margin of \$0.62357 per therm is substantially higher than  
25 Southwest's margin, which is \$0.48762 for the first block (20 therms in the summer and  
26 40 therms in the winter) and \$0.40344 per therm for the second block. Similarly a

1 comparison of existing general commercial tariff rates shows that Black Mountain's  
2 margin of \$0.62357 per therm is substantially higher than Southwest's margins of  
3 \$0.38024 per therm for small commercial customers and \$0.27211 per therm for medium  
4 commercial customers.

5  
6 Continued application of the higher Black Mountain margins to Cave Creek Division  
7 customers after Black Mountain is dissolved into Southwest would inequitably burden the  
8 former Cave Creek Division customers with higher rates than any other similarly situated  
9 Southwest customers in Arizona are paying, for an indeterminate period of time, possibly  
10 until new rates from a future Southwest rate proceeding would go into effect. Under  
11 Southwest's proposal, Cave Creek customers would be unlikely to see any substantial rate  
12 benefit from the acquisition before a future Southwest rate proceeding.

13  
14 Further, having a block of almost 8,000 customers in the Cave Creek area paying  
15 substantially higher rates than nearby and otherwise identical Southwest customers for a  
16 significant period of time is likely to lead to customer complaints of inequitable treatment.

17  
18 **Q. What is Staff's recommendation regarding the margin rates Cave Creek customers**  
19 **would be charged as a result of the acquisition?**

20 A. BMG shall dissolve as a corporate entity on or before July 1, 2004. At the  
21 completion of the dissolution, BMG shall file a notice within this docket attesting to the  
22 specific date that the BMG dissolution was completed (herein referred to as the "noticed  
23 date"). Upon the noticed date of dissolution, the transfer of BMG's CC&N to SWG shall  
24 be deemed effective. As well, SWG's authorized natural gas rates and charges in their  
25 entirety shall be deemed the authorized rates and charges for Cave Creek Division  
26 customers' effective the noticed date of BMG's dissolution. If BMG fails to complete

1 dissolution by July 1, 2004, as discussed in above. BMG shall file a sufficient rate  
2 application with the Arizona Corporation Commission ("Commission" or "ACC") on or  
3 before July 1, 2004. Please note, this condition shall not limit Staff's ability to initiate a  
4 rate case at anytime. Furthermore, in no case shall the currently authorized BMG rates  
5 and charges remain in effect beyond July 1, 2004, without BMG initiating a sufficient rate  
6 application with the Commission.

7  
8 This course of action would result in the Cave Creek customers, once they become  
9 Southwest customers, being charged the same rates as all other similarly situated  
10 Southwest customers, thereby avoiding any on-going rate disparity. This would also  
11 provide Cave Creek customers with the tangible benefit of lower rates from the  
12 acquisition.

13  
14 Further, Southwest has proposed to change all other rates and rate components apart from  
15 the Cave Creek margin rates. It is more straightforward and simple to convert all the rates  
16 and rate components at once, rather than changing some rate components now and leaving  
17 the margin rates until later. Piecemeal conversion of rates could result in customer  
18 confusion.

19  
20 **Q. Could Southwest or BMG avoid such rate disparities and the possible problems such**  
21 **rate disparities might cause?**

22 **A.** Yes. Southwest or BMG could voluntarily agree to either implement the existing  
23 Southwest rates for the current Black Mountain Cave Creek Division customers at the  
24 time the stock transfer is completed, or to file shortly thereafter to implement Southwest's  
25 rates for these customers. This would result in an immediate and substantive reduction in  
26 rates for most Cave Creek Division customers and would avoid possible confusion during



1 the interim period between when the Commission would approve the acquisition and  
2 when Southwest's rates would be applied to the current Black Mountain Cave Creek  
3 Division customers.

4  
5 **Q. Please compare and contrast the impact on each existing Cave Creek Division rate**  
6 **class of retaining the existing Cave Creek Division rates or adopting Southwest's**  
7 **rates.**

8 **A.** The following questions and answers address the rate differences for each class of the  
9 existing Cave Creek Division rates and Southwest rates. For comparison purposes, the  
10 rates used are those reflected in Southwest's response to the Residential Utility Consumer  
11 Office ("RUCO") Data Request BLKMTN-1-13, which is attached to this testimony as  
12 Exhibit RG-2. Given that the monthly PGA rate for both Southwest and the Cave Creek  
13 Division has not changed since early 2002, the rates reflected in the above referenced data  
14 request are reflective of the rates paid by Southwest and Cave Creek Division customers  
15 through much of 2002. The only adjustment Staff has made to the numbers provided by  
16 Southwest in this data request is that Staff has used Southwest's cost of gas values for  
17 both sets of rates, to provide a consistent basis for comparison. Exhibit RG-3 contains a  
18 summary comparison of customer bills under the two sets of rates. Staff's review of the  
19 bill impacts on Cave Creek customers utilizes the bill count information for the 1999 test  
20 year used in the Cave Creek Division's most recent rate proceeding. There does not  
21 appear to be any reason why the usage characteristics reflected in the 1999 test year would  
22 be substantively different than current usage characteristics.

23  
24 **Q. How would Cave Creek Division residential customers be impacted by a switch to**  
25 **Southwest's residential tariff(s)?**

1 A. Southwest's residential rates reflect substantially lower margin rates, with Black  
2 Mountain's margin of \$0.62357 per therm eclipsing Southwest's margin, which is  
3 \$0.48762 for the first block (20 therms in the summer and 40 therms in the winter) and  
4 \$0.40344 per therm for the second block. However, Southwest has a higher customer  
5 charge of \$8.00, compared to Black Mountain's \$6.00 customer charge.

6  
7 Based upon an average monthly usage level of 59 therms, the average Cave Creek  
8 residential customer would see a reduction in his/her average bill from \$72.73 under the  
9 BMG Cave Creek Division rates to \$63.43 under Southwest's rates. The vast majority of  
10 this reduction would be concentrated in the heating season months, both due to high usage  
11 levels in those months and the greater impact that Southwest's lower second block in the  
12 rate structure will have during winter months. A comparison of monthly bills at various  
13 usage levels indicates that Cave Creek customers would see a lower monthly bill in  
14 months when they use 15 or more therms.

15  
16 **Q. How would Cave Creek Division commercial customers be impacted by a switch to**  
17 **Southwest's commercial tariff(s)?**

18 A. Southwest's commercial rates reflect substantially lower margin rates for both small and  
19 medium commercial customers. Under Southwest's tariff, a small commercial customer  
20 uses up to 600 therms per month, a medium commercial customers uses more than 600 but  
21 less than 15,000 therms per month, and a large commercial customer uses more than  
22 15,000 therms per month. The BMG Cave Creek Division rates schedules do not divide  
23 commercial customers into different classes based upon usage levels. It does not appear  
24 that any of Black Mountain's commercial tariff customers would switch to Southwest's  
25 large commercial tariff rates. Southwest's margins of \$0.38024 per therm for small  
26 commercial customers and \$0.27211 per therm for large commercial customers are much

1 lower than Black Mountain's commercial tariff's margin rate of \$0.62357 per therm.  
2 However, Southwest's customer charges of \$20.00 for small commercial customers and  
3 \$90.00 for medium commercial customers are higher than Black Mountain's \$15.00  
4 customer charge. The effect that was seen with residential customers happens again with  
5 commercial customers, with all but very low usage commercial customers benefiting from  
6 a switch to Southwest's rates.

7  
8 Based upon an average monthly usage level of 437 therms, the average Cave Creek  
9 commercial customer would see a reduction in his/her average bill from \$505.06 under the  
10 BMG Cave Creek Division rates to \$403.73 under Southwest's small commercial rates. A  
11 comparison of monthly bills at various usage levels indicates that Cave Creek customers  
12 would see a lower monthly bill in months when they use 21 or more therms.

13 A medium commercial customer using 2,000 therms a month would see a reduction in  
14 his/her bill from \$2,257.86 under the BMG Cave Creek Division rates to \$1,629.94 under  
15 Southwest's rates. A comparison of monthly bills at various usage levels indicates that  
16 Cave Creek customers who would qualify as medium commercial customers would see a  
17 lower monthly bill in months when they use 214 or more therms.

18  
19 **Q. What other customers does the Cave Creek Division have, other than those served**  
20 **through the residential and commercial tariffs?**

21 **A.** The vast majority of the Cave Creek Division's customers are served under the residential  
22 and commercial tariffs. A very small number of customers are served under the Cave  
23 Creek Division's Resort, Gas Air Conditioning, Cogeneration, and Compressed Natural  
24 Gas (CNG) tariffs. According to the 1999 test year bill counts, there were less than 20  
25 customers served on these tariffs, with most of these customers on the Resort tariff. It  
26 should be recognized that the CNG tariff was not in effect during 1999.

1  
2 **Q. How would Cave Creek Division customers served under the Resort, Gas Air**  
3 **Conditioning, Cogeneration, and CNG tariffs be impacted by a switch to Southwest's**  
4 **comparable tariff(s)?**

5 A. For Resort tariff customers, Southwest's margin rates are significantly lower, whether the  
6 customers switch to small commercial service or medium commercial service. The BMG  
7 Resort tariff customer charge of \$30.00 is higher than Southwest's small commercial  
8 customer charge of \$20.00, but less than Southwest's medium commercial customer  
9 charge of \$90.00. Therefore, customers switching to the small commercial tariff would  
10 see savings regardless of usage levels, while customers switching to the medium  
11 commercial tariff would see savings if their monthly usage is 171 therms or greater. A  
12 small commercial customer using 300 therms would see a reduction from \$366.43 to  
13 \$283.43. A medium commercial customer using the 1999 monthly average usage of 991  
14 therms would see a reduction from \$1,141.34 to \$853.04.

15  
16 For gas air conditioning tariff customers, a customer would see an increase of the  
17 customer service charge from \$6.00 to \$20.00 and a slight reduction in the per therm rate,  
18 assuming the customer switches to Southwest's commercial air conditioning tariff,  
19 Schedule G-40. A comparison of bills under the two rate structures indicates that  
20 customers would see very little difference in his/her monthly bills due to a switch from  
21 BMG Cave Creek rates to Southwest rates. This is understandable, given that when the  
22 BMG Cave Creek CNG tariff was implemented, it was based at least to some extent on  
23 Southwest's CNG tariff. A customer using 1,000 therms per month would see a miniscule  
24 increase in his/her bill from \$593.86 to \$593.99 by switching to Southwest's rate.  
25

1 For customers served under the Cave Creek Division's cogeneration tariff, customers  
2 would see an increase in their customer service charge from \$30.00 to \$90.00 and a  
3 decrease in their per therm rate from \$0.55786 per therm to \$0.53713 per therm under  
4 Southwest's Schedule G-60. Again, the bill comparisons indicate that cogeneration  
5 customers would see very little change in their bills as a result of switching from BMG  
6 Cave Creek Division rates to Southwest rates. For example, a cogeneration customer  
7 consuming the 1999 average usage level of 4,174 therms per month would see his/her  
8 monthly bill reduced from \$2,358.51 to \$2,331.98. It should be noted that for  
9 cogeneration customers, the long term impacts of the switch to Southwest rates is less  
10 clear due to the manner in which Southwest calculates the gas cost portion of its G-60 rate.  
11 The gas cost rate for this class (and Southwest's G-80 class) is reset every six months,  
12 based upon fixed price purchases Southwest makes for these specific customer classes.  
13 Therefore, if there is a significant shift in the gas cost for Schedule G-60, that would  
14 impact the currently small differential between Black Mountain and Southwest rates for  
15 cogeneration customers.

16  
17 For customers served under the BMG Cave Creek Division CNG tariff, there would be an  
18 increase in the customer charge from \$6.00 to \$8.00 and an increase in the per therm rate  
19 from \$0.55786 to \$0.5872 per therm. Such customers would see a small increase in rates  
20 regardless of usage levels. As previously noted, this tariff was introduced after the rate  
21 case where the 1999 test year was utilized, so there is not any bill count information  
22 available for this class of customers from the 1999 test year. However, in Black  
23 Mountain's filing for approval of the tariff, it assumed there would be a typical usage of  
24 52 therms per month, so Staff has used this typical usage to show an example of the rate  
25 change impact in this case. A CNG customer using 52 therms would see an increase in  
26 his/her monthly bill from \$35.01 to \$38.53.

1  
2 **Q. Please summarize your findings regarding the rate impacts on Cave Creek Division**  
3 **customers of switching to Southwest's tariffed rates.**

4 A. Most BMG Cave Creek Division customers would see a significant rate decrease if they  
5 were switched to the applicable Southwest tariffs as a result of the proposed acquisition.  
6 For the residential and commercial tariffs, which represent upwards of 99 percent of Cave  
7 Creek Division customers according to the 1999 bill count information, only some very  
8 low usage residential and commercial tariff customers would experience slightly higher  
9 monthly bills, which would primarily be summer residential bills. Such customers would  
10 in all likelihood more than make up for their slightly higher summer bills with significant  
11 bill savings during the winter heating season.  
12

13 **PURCHASED GAS ADJUSTOR**

14 **Q. Has Southwest made any recommendations regarding the Cave Creek Division's**  
15 **purchased gas adjustor?**

16 A. Yes. In Southwest's application, the company states that it intends to merge the PGA  
17 bank balances of Southwest and the Cave Creek Division and apply Southwest's cost of  
18 gas to Cave Creek Division customers after the approval of the acquisition. Further,  
19 Southwest has indicated that it would apply a 12 month PGA surcharge or credit to Cave  
20 Creek Division customers to account for any over or under-collection in the Cave Creek  
21 PGA bank balance at the time of the approval of the acquisition. During the 12 month  
22 period when the PGA surcharge or credit is in place, Cave Creek Division customers  
23 would not be subject to any PGA surcharge or credit in place for other Southwest  
24 customers.  
25

26 **Q. Does Staff have any recommendations regarding the PGA mechanism?**

1 A. Yes. I recommend that the Cave Creek PGA mechanism, cost of gas reflected in the tariff,  
2 and PGA bank balance be merged with their counterparts at Southwest on the BMG  
3 dissolution completion date stated in a Notice to be filed in this docket. This would  
4 coincide with Staff's recommended implementation of Southwest's rates in the Cave  
5 Creek Division. In the interim period, to the extent Southwest begins purchasing gas for  
6 Black Mountain, Southwest could allocate a pro rata share of its Arizona purchases to  
7 Black Mountain to meet Black Mountain's needs. To the extent such an implementation  
8 plan raises operational or technical issues for Southwest, Staff is ready and willing to work  
9 with the company to address those issues. Regarding the structure and function of the  
10 PGA mechanism, there should be no changes to the PGA mechanism in this proceeding  
11 for either Southwest or Black Mountain from the PGA mechanism that was implemented  
12 by Commission Decision No. 61225 (October 30, 1998) and subsequent decisions.

13  
14 **Q. Does Staff have any recommendations regarding the Cave Creek Division's PGA**  
15 **bank balance?**

16 A. No. Currently both the BMG Cave Creek Division and Southwest Gas have sizable  
17 overcollected PGA bank balances. However it cannot be assumed that at the time the  
18 Commission acts on the acquisition that these sizable overcollections will exist for one or  
19 both companies. It is likely that between now and any approval of the acquisition that  
20 Arizona will have experienced some or all of the 2002-2003 heating season. Natural gas  
21 prices are very volatile and it is possible that factors such as a cold winter, higher demand,  
22 or declining production rates could lead to some form of price spike during the heating  
23 season that could impact the overcollected PGA bank balances. Staff does not  
24 recommend any specific action regarding the PGA bank balances at this time. Staff and  
25 Southwest typically have on-going discussions regarding PGA matters such as the PGA  
26 bank balance. If some form of action is required in relation to the PGA bank balances at

1 the time of Black Mountain's stated dissolution, such action could be initiated by Staff or  
2 Southwest. As with the conversion of rates from the BMG Cave Creek Division's to  
3 Southwest's, Staff is willing to work with the company to address any operational or  
4 technical details which may arise.

5  
6 **OTHER RATES/SERVICES**

7 **Q. Does Staff recommend that Southwest's miscellaneous service charges be adopted for**  
8 **the Cave Creek Division customers at the time Black Mountain is stated to be**  
9 **completely dissolved?**

10 **A.** Yes. Exhibit RG-4 shows a comparison of the miscellaneous service charges for  
11 Southwest and Black Mountain's two divisions. Southwest's miscellaneous service  
12 charges are generally less than the existing charges in the Cave Creek Division and  
13 therefore it is expected that Cave Creek Division customers would benefit from adoption  
14 of Southwest's miscellaneous service charges.

15  
16 **GAS SUPPLY PROCUREMENT**

17 **Q. Does Staff believe that the proposed acquisition of Black Mountain will have a**  
18 **discernable impact on Southwest's gas procurement activities?**

19 **A.** No. Given the relative size of Southwest and Black Mountain, the addition of Black  
20 Mountain's natural gas needs will represent a very small increment of additional gas  
21 demand for Southwest to acquire.

22  
23 **Q. Please discuss the impact Southwest's acquisition of Black Mountain could have on**  
24 **the procurement of natural gas supplies for the Cave Creek Division's customers.**

25 **A.** The high level of uncertainty in a number of dockets at the Federal Energy Regulatory  
26 Commission ("FERC") regarding pipeline capacity rights on the El Paso pipeline system



1 complicates efforts to compare and contrast gas supply procurement with or without  
2 Southwest's acquisition of Black Mountain. However, even in such uncertain times, it is  
3 possible to consider possible advantages or disadvantages of different gas supply  
4 procurement scenarios. The two major aspects of gas supply procurement are the  
5 purchasing of the natural gas commodity and the acquisition of pipeline capacity rights on  
6 the interstate pipeline system to deliver the natural gas commodity to the local distribution  
7 company's ("LDC") service area. As with the entire Phoenix metropolitan area, the Cave  
8 Creek Division is entirely dependent on the El Paso pipeline system to meet its gas supply  
9 needs.

10  
11 On the El Paso pipeline, both Southwest and Black Mountain are currently full  
12 requirements shippers. However, Southwest is considered an FT-1 shipper (a large full  
13 requirements shipper), while Black Mountain is considered an FT-2 shipper (a small full  
14 requirements shipper). Historically, the contracts rights of FT-1 and FT-2 shippers have  
15 been similar. However, under proposals currently being considered at the FERC, FT-1  
16 shippers, including Southwest, would be forcibly converted to contract demand ("CD")  
17 contracts, which will greatly reduce the operational flexibility of such shippers as they try  
18 to access preferable gas supplies. Due to their insignificant size on the El Paso system, it  
19 appears highly likely that any new capacity allocation proposal adopted by the FERC  
20 would allow FT-2 shippers to retain their full requirements rights. Under such full  
21 requirements rights, Black Mountain could source all of its gas supplies out of the supply  
22 basin of its choice, while Southwest's likely CD rights would be more restricted in how  
23 much gas can be sourced from each supply basin. The pipeline capacity allocation issues  
24 currently before FERC have implications for Cave Creek Division customers whether  
25 Southwest acquires Black Mountain or not.  
26

1     **Q.     Please discuss the possible advantages or disadvantages of Southwest's acquisition of**  
2     **Black Mountain on the procurement of gas supplies to serve Cave Creek Division**  
3     **customers.**

4     A.     While Southwest is a much larger southwestern LDC than Black Mountain, Black  
5     Mountain's parent company, Xcel Energy, also has large LDC operations. Therefore,  
6     whether Black Mountain is acquired or not, the Cave Creek Division customers are likely  
7     to be served by an organization with a significant amount of gas procurement expertise.  
8     However, it is possible, given Southwest's focus on southwestern natural gas markets, that  
9     such a regional focus could lead to some benefits in the procurement of gas supplies.

10  
11     Regarding the on-going FERC matters, Cave Creek Division customers are likely to be  
12     more directly impacted in the short term if they are part of Southwest than if they remain  
13     with Black Mountain. As noted before, Black Mountain purchases some of its' gas  
14     supplies through its FT-2 contract with El Paso and some of its supplies from Southwest  
15     through Schedule G-95. If the acquisition is approved, it is likely that Black Mountain's  
16     FT-2 contract rights would be converted into CD rights and be combined with what are  
17     likely to be Southwest's new CD rights on El Paso. The main implication of this would  
18     likely be that rather than being able to source all of its gas supplies for the Cave Creek  
19     Division customers from the most inexpensive supply basin under Black Mountain's FT-2  
20     contract, some portion of the gas to serve these customers would likely have to be sourced  
21     from higher priced basins.

22  
23     Regarding the portion of Black Mountain's gas supplies that are purchased through  
24     Southwest's Schedule G-95, these gas costs would be impacted by any increase in costs  
25     which Southwest would experience as a result of the on-going proceedings at FERC.

26

1 In summary, although benefits are possible, it is not clear that there will be any substantive  
2 gas supply procurement benefit to Cave Creek Division customers as a result of the  
3 proposed acquisition and it is possible that the cost of gas to serve Cave Creek Division  
4 customers could actually increase as a result of the acquisition. This is in large measure  
5 due to the uncertainty of Southwest's future contract rights and related costs at stake in the  
6 current FERC proceedings.

7  
8 **PAGE DIVISION**

9 **IMPACT OF ACQUISITION ON CUSTOMER RATES, PURCHASED GAS ADJUSTOR,**  
10 **AND OTHER RATES/SERVICES**

11 **Q. Please describe Black Mountain's Page Division.**

12 A. The Page Division is located in Page, Arizona and is served with propane. As of the  
13 monthly PGA report filed at the end of October, 2002, the Page Division serves 1,106  
14 residential customers and 197 commercial customers, with sales of 1,134,340 therms from  
15 October 2001 through September 2002. The Page Division is a stand-alone propane  
16 distribution system and receives its propane supplies by truck delivery from out-of-state  
17 propane suppliers.

18  
19 **Q. Has Southwest made any proposals regarding the treatment of rates paid by Black**  
20 **Mountain customers as a result of the acquisition?**

21 A. For the Page Division, Southwest anticipates that the existing rates would be unaffected  
22 by the acquisition and Southwest further anticipates sale of the Page Division within 12  
23 months of completion of its acquisition of Black Mountain. Southwest has not proposed  
24 any changes to the Page Division's PGA mechanism or PGA bank balance.

25

1    **Q.    Should the Page Division receive treatment similar to that which Staff has**  
2    **recommended for the Cave Creek Division?**

3    A.    The Page Division's geographical isolation, the uniqueness of its propane operations in  
4    comparison to Southwest's other Arizona operations and Black Mountain's Cave Creek  
5    Division operations, and the fact that Southwest has indicated that it intends to sell the  
6    Page Division within 12 months of its acquisition of Black Mountain, are compelling  
7    reasons why the Page Division may warrant different treatment than that which Staff  
8    recommends for the Cave Creek Division. However, if the Page Division is not sold on a  
9    timely basis, as contemplated in Southwest's application, steps should be taken to ensure  
10   that Page Division customers receive possible benefits from the purchase of Black  
11   Mountain by Southwest.

12  
13   **Q.    Does Staff have any recommendations regarding the Page Division?**

14   A.    Yes. First, if SWG fails to sell BMG's Page Propane Division at or prior to the noticed  
15   date of BMG's dissolution, SWG shall take all appropriate and timely steps to ensure rates  
16   and charges are in place for the current BMG propane customers, such as: SWG filing a  
17   request to charge BMG's existing rates, or SWG filing a report amending SWG's filing in  
18   this case clarifying that BMG as a corporate entity would remain intact for the sole  
19   purpose of providing the same propane service as BMG's Page Division currently  
20   provides in its propane operations.

21  
22   Second, if SWG fails to file for Commission approval of the sale of BMG's Page Division  
23   within 18 months of the Commission's approval of SWG's acquisition of BMG, the Page  
24   Division should within 19 months of a decision in this case make a filing for Commission  
25   approval to begin offering the Page Division propane customers service options that are  
26   currently available to SWG's customers. Such services include, but are not limited to, a

1 low income discount tariff for residential customers, a balanced payment plan option, an  
2 online bill payment option, and applicable demand-side management programs.

3  
4 **SUMMARY**

5 **Q. Please summarize your recommendations.**

6 A. Staff's recommendations are as follows for the Cave Creek Division:

7 1. BMG shall dissolve as a corporate entity on or before July 1, 2004. At the  
8 completion of the dissolution, BMG shall file a notice within this docket attesting to the  
9 specific date that the BMG dissolution was completed (herein referred to as the "noticed  
10 date"). Upon the noticed date of dissolution, the transfer of BMG's CC&N to SWG shall  
11 be deemed effective. As well, SWG's authorized natural gas rates and charges in their  
12 entirety shall be deemed the authorized rates and charges for Cave Creek Division  
13 customers' effective the noticed date of BMG's dissolution. If BMG fails to complete  
14 dissolution by July 1, 2004, as discussed in above, BMG shall file a sufficient rate  
15 application with the Arizona Corporation Commission ("Commission" or "ACC") on or  
16 before July 1, 2004. Please note, this condition shall not limit Staff's ability to initiate a  
17 rate case at anytime. Furthermore, in no case shall the currently authorized BMG rates  
18 and charges remain in effect beyond July 1, 2004, without BMG initiating a sufficient rate  
19 application with the Commission.

20  
21 2. The Cave Creek Division PGA mechanism shall be merged with Southwest's PGA  
22 mechanism on date of Black Mountain's completed dissolution.

23  
24 Staff's recommendations are as follows for the Page Division:

25 1. If SWG fails to sell BMG's Page Propane Division at or prior to the noticed date of  
26 BMG's dissolution, SWG shall take all appropriate and timely steps to ensure rates and

1 charges are in place for the current BMG propane customers, such as: SWG filing a  
2 request to charge BMG's existing rates, or SWG filing a report amending SWG's filing in  
3 this case clarifying that BMG as a corporate entity would remain intact for the sole  
4 purpose of providing the same propane service as BMG's Page Division currently  
5 provides in its propane operations.

- 6
- 7 2. If SWG fails to file for Commission approval of the sale of BMG's Page Division within  
8 18 months of the Commission's approval of SWG's acquisition of BMG, the Page  
9 Division should within 19 months of a decision in this case make a filing for Commission  
10 approval to begin offering the Page Division propane customers service options that are  
11 currently available to SWG's customers. Such services include, but are not limited to, a  
12 low income discount tariff for residential customers, a balanced payment plan option, an  
13 online bill payment option, and applicable demand-side management programs.

14

15 **Q. Does this conclude your testimony?**

16 **A.** Yes, it does.

## RESUME

**ROBERT G. GRAY**

### Education

B.A. Geography, University of Minnesota-Duluth (1988)

M.A. Geography, Arizona State University (1990) Thesis: *A Model for Optimizing the Federal Express Overnight Delivery Aircraft Network.*

### Employment History

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Senior Economist (August 1997 - present), Economist II (June 1991 - July 1997), Economist I (June 1990 - June 1991). Conduct economic and policy analyses of issues related to the natural gas, electric, and telecommunications utilities. Prepare recommendations and present written and oral testimony before the Commission on various utility industry issues. Use statistical techniques such as regression analysis and factor analysis in a variety of studies to forecast and explain causes and effects. Represent the ACC in natural gas proceedings at the Federal Energy Regulatory Commission. Conduct working group/workshop activities including organizing meetings, moderating meetings, and analyzing and reporting working group findings.

### Testimony

Resource Planning for Electric Utilities, (Docket No. 0000-90-088), Arizona Corporation Commission, 1990.

Citizens Utilities Company, Electric Rate Case (Docket No. E-1032-92-073), Arizona Corporation Commission, 1993.

Resource Planning for Electric Utilities, (Docket No. 0000-93-052), Arizona Corporation Commission, 1993.

Arizona Public Service Company, Rate Settlement (Docket No. E-1345-94-120), Arizona Corporation Commission, 1994.

U S West Communications, Rate Case (Docket No. E-1051-93-183), Arizona Corporation Commission, 1995.

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Citizens Utilities Company, Electric Rate Case (Docket No. E-1032-95-433), Arizona Corporation Commission, 1996.

Southwest Gas Corporation, Natural Gas Rate Case (Docket No. U-1551-96-596), Arizona Corporation Commission, 1997.

Black Mountain Gas Company - Northern States Power Company, Merger (Docket Nos. G-03493A-98-0017, G-01970A-98-0017), Arizona Corporation Commission, 1998.

Black Mountain Gas Company - Page Division Rate Case (Docket Nos. G-03493A-98-0695, G-03493A-98-0705), Arizona Corporation Commission, 1999.

Graham County Utilities Company Rate Case (Docket No. G-02527A-00-0378), Arizona Corporation Commission, 2000.

Black Mountain Gas Company - Cave Creek Division Rate Case (Docket No. G-03703A-00-0283), Arizona Corporation Commission, 2000.

Southwest Gas Corporation, Natural Gas Rate Case (Docket No. G-01551A-00-0309), Arizona Corporation Commission, 2000.

Black Mountain Gas Company - Page Division Rate Case (Docket Nos. G-03493A-01-0263), Arizona Corporation Commission, 2001.

Duncan Rural Services - Natural Gas Rate Case (Docket No. G-02528A-01-0561), Arizona Corporation Commission, 2001.

### **Publications**

(with David Berry, Kim Clark, Lewis Gale, Barbara Keene, and Harry Sauthoff) Staff Report on Resource Planning. (Docket No. U-0000-90-088) Arizona Corporation Commission, 1990.

(with Prem Bahl) "Transmission Access Issues: Present and Future," October, 1991.

(with David Berry) Substitution of Photovoltaics for Line Extensions: Creating Consumer Choices. Arizona Corporation Commission, 1992.

(with Barbara Keene and Kim Clark) Report of the Task Force on the Feasibility of Implementing Sliding Scale Hookup Fees, December, 1992.



(with Mike Kuby) "The Hub and Network Design Problem With Stopovers and Feeders: The Case of Federal Express," Transportation Research A, Vol. 27A, 1993, pp. 1-12.

(with David Berry) Staff Guidelines on Photovoltaics Versus Line Extensions. Arizona Corporation Commission, January 28, 1993.

(with Ray Williamson, Robert Hammond, Frank Mancini, and James Arwood) The Solar Electric Option (Instead of Power Line Extension). A joint publication of the Arizona Corporation Commission and the Arizona Department of Commerce Energy Office, August, 1993.

(with David Berry, Kim Clark, Barbara Keene, Jesse Tsao, Ray Williamson, Randall Sable, Roni Washington, Wilfred Shand, and Prem Bahl) Staff Report on Resource Planning. (Docket No. U-0000-93-052) Arizona Corporation Commission, 1993.

Staff Report On Rural Local Calling Areas. (Docket No. E-1051-93-183) Arizona Corporation Commission, March, 1994.

(with David Berry, Kim Clark, Barbara Keene, Glenn Shippee, Julia Tsao, and Ray Williamson) Staff Report on Resource Planning. (Docket No. U-000-95-506) Arizona Corporation Commission, 1996.

(with Barbara Keene) "Customer Selection Issues," NRRI Quarterly Bulletin, Vol. 19, No. 1, Spring 1998, National Regulatory Research Institute.

Staff Report on Purchased Gas Adjustor Mechanisms, (Docket No. G-00000C-98-0568) Arizona Corporation Commission, October 19, 1998.

Staff Report on the Rolling Average PGA Mechanism, (Docket No. G-00000C-98-0568), Arizona Corporation Commission, September 6, 2000.

#### **Additional Training**

1990	Seminars on Regulatory Economics
1993	PURTI course on Public Utilities and the Environment
1996	Center for Public Utilities Workshop on Gas Unbundling and Retail Competition
1997	NARUC 6 <sup>th</sup> Annual Natural Gas Conference
1998	Local Distribution Company Restructuring and Retail Access and Competition Conference
1998	NARUC 7 <sup>th</sup> Annual Natural Gas Conference
1999 – 2002	NARUC Summer Committee Meetings
2001	Center for Public Utilities Workshop on Risk Management in Gas Purchasing

Exhibit RG-1  
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**Memberships**

NARUC - Staff Subcommittee on Gas – Vice-Chair (2002- )

Schedule RGG-2

SOUTHWEST GAS CORPORATION  
ACQUISITION OF BLACK MOUNTAIN GAS COMPANY

\*\*\*

RESIDENTIAL UTILITY CONSUMER OFFICE  
DATA REQUEST RUCO-BLKMTN NO. 1  
(RUCO-BLKMTN-1-1 THROUGH RUCO-BLKMTN-1-18)

DOCKET NO.: G-01551A-02-0425  
COMMISSION: ARIZONA CORPORATION COMMISSION  
DATE OF REQUEST: AUGUST 6, 2002

Request No. RUCO-BLKMTN-1-13:

Rate Relief - Please provide the following information regarding rate relief:

- a. Does Southwest anticipate a need to file for rate relief within 36 months of the Commission's approval of the sale and transfer?
- b. Explain the basis for the conclusion to "part a" and provide documentation to support this conclusion.
- c. Does Southwest intend to eventually consolidate Black Mountain's rates with its other Arizona gas rates?
- d. Provide a comparison, by customer class, of Southwest's existing rates with Black Mountain's existing rates.

Respondent: Pricing

Response:

- a. Southwest monitors and evaluates the results of its operations to determine if and when it needs to file for rate relief. The timing of this filing is independent of the BMG acquisition.
- b. See response to part a.
- c. Yes.
- e. See attached.

Description	Base Tariff Rate		Rate Adjustment	Monthly	Effective	
	Margin	Gas Cost		Gas Cost Adjustment		Tariff Rate
SWG						
G-5 - Residential Gas Service						
Basic Service Charge	\$	8.00			\$ 8.00	
Commodity Charge per Therm						
Summer (May - October):						
First 20 Therms	\$	0.48762	\$ 0.37034	\$ 0.00967	\$ 0.12752	\$ 0.99515
Over 20 Therms	\$	0.40344	\$ 0.37034	\$ 0.00967	\$ 0.12752	\$ 0.91097
Winter (November - April):						
First 40 Therms	\$	0.48762	\$ 0.37034	\$ 0.00967	\$ 0.12752	\$ 0.99515
Over 40 Therms	\$	0.40344	\$ 0.37034	\$ 0.00967	\$ 0.12752	\$ 0.91097
G-25 General Gas Service						
Basic Service Charge						
Small	\$	20.00			\$ 20.00	
Medium	\$	90.00			\$ 90.00	
Commodity Charge Per Therm						
Small - All Usage	\$	0.38024	\$ 0.37034	\$ 0.00967	\$ 0.12752	\$ 0.88777
Medium - All Usage	\$	0.27211	\$ 0.37034	\$ 0.00967	\$ 0.12752	\$ 0.77964
BMG						
GS-1 Gas Service						
Residential	\$	6.00			\$ 6.00	
Commercial	\$	15.00			\$ 15.00	
Resort	\$	30.00			\$ 30.00	
Commodity Charge Per Therm - All Usage	\$	0.62357	\$ 0.42000	\$ -	\$ 0.06450	\$ 1.10807
SWG						
G-40 Air Conditioning Gas Service						
Basic Service Charge	Customers otherwise applicable rate.					
Commodity Charge Per Therm - All Usage	\$	0.07613	\$ 0.37034	\$ -	\$ 0.12752	\$ 0.57399
BMG						
GA-1 Gas Air Conditioning Service						
Basic Service Charge	\$	6.00			\$ 6.00	
Commodity Charge Per Therm - All Usage	\$	0.09000	\$ 0.42000	\$ -	\$ 0.06450	\$ 0.57450
SWG						
G-60 Cogeneration Gas Service						
Basic Service Charge	Customers otherwise applicable rate.					
Commodity Charge Per Therm - All Usage	\$	0.08934	\$ 0.44779	\$ -	\$ -	\$ 0.53713
BMG						
CG-1 Cogeneration/Chiller service						
Basic Service Charge	\$	30.00			\$ 30.00	
Commodity Charge Per Therm - All Usage	\$	0.06000	\$ 0.42000	\$ -	\$ 0.06450	\$ 0.54450
SWG						
G-55 Gas Service for Compression						
Basic Service Charge						
Small	\$	20.00			\$ 20.00	
Large	\$	170.00			\$ 170.00	
Residential	\$	8.00			\$ 8.00	
Commodity Charge Per Therm - All Usage	\$	0.13305	\$ 0.37034	\$ -	\$ 0.12752	\$ 0.63091
BMG						
CNG-1 Compressed Natural Gas						
Basic Service Charge	\$	6.00			\$ 6.00	
Commodity Charge Per Therm - All Usage	\$	0.13000	\$ 0.42000	\$ -	\$ 0.06450	\$ 0.61450

Schedule RGG-3

# Comparison of Black Mountain Gas - Cave Creek Division Rates and Southwest Gas Rates

Note: Rates may adjust, due to changes in natural gas costs and their reflection through the PGA mechanism. With the exception of the cogeneration tariff comparison, the existing Southwest Gas cost of gas data is applied to both sets of rates to provide a consistent basis for comparison. Comparisons are based upon rates shown in RUOCO Data Request BLKMTN-1-13. Southwest's cost of gas values are used to provide a consistent basis for comparison.

## Residential Service Tariff

	BMG - Cave Creek		Southwest Gas		BMG Cost Components		SW Gas Cost Components		
	Schedule R-1		Schedule G-5		Margin	Gas Cost	Margin	Base Cost of Gas	PGA Rate Monthly Rate Adjustment
Basic Service Charge	\$6.00		\$8.00						
summer 1st 20 therms - per therm	\$1.13110		\$0.99515		\$0.62357	\$0.50753	\$0.48762	\$0.37034	\$0.12752 \$0.00967
summer after 1st 20 therms - per therm	\$1.13110		\$0.91097		\$0.62357	\$0.50753	\$0.40344	\$0.37034	\$0.12752 \$0.00967
winter 1st 40 therms - per therm	\$1.13110		\$0.99515		\$0.62357	\$0.50753	\$0.48762	\$0.37034	\$0.12752 \$0.00967
winter after 1st 40 therms - per therm	\$1.13110		\$0.91097		\$0.62357	\$0.50753	\$0.40344	\$0.37034	\$0.12752 \$0.00967
Bill Comparisons									
Summer - 10 therms		BMG - Cave Creek	Southwest Gas						
		\$17.31	\$17.95						
Summer - 15 therms		\$22.97	\$22.93						
Summer - 30 therms		\$39.93	\$37.01						
Summer - 50 therms		\$62.56	\$55.23						
Summer - 59 therms		\$72.73	\$63.43						
Winter - 15 therms		\$22.97	\$22.93						
Winter - 30 therms		\$39.93	\$37.85						
Winter - 59 therms		\$72.73	\$65.11						
Winter - 75 therms		\$90.83	\$79.69						
Winter - 100 therms		\$119.11	\$102.46						
Winter - 150 therms		\$175.67	\$148.01						
1999 avg. monthly usage		59							

# Commercial Tariff

Basic Service Charge  
per therm rate

Bill Comparisons

20 therms  
30 therms  
100 therms  
200 therms  
300 therms  
400 therms  
437 therms  
500 therms  
600 therms

1999 avg. monthly usage

# Commercial Tariff

Basic Service Charge  
per therm rate

Bill Comparisons

213 therms  
437 therms  
700 therms  
1000 therms  
2000 therms  
3000 therms  
4000 therms  
5000 therms  
6000 therms

1999 avg. monthly usage

BMG - Cave Creek Southwest Gas  
Schedule C-1 G-25 (Small)

\$15.00 \$20.00  
\$1.12143 \$0.87810

BMG Cost Components

SW Gas Cost Components

Margin Gas Cost Margin of Gas Base Cost Monthly Rate  
PGA Rate Adjustment

\$0.62357 \$0.49786 \$0.38024 \$0.37034 \$0.12752 \$0.00000

BMG - Cave Creek Southwest Gas

\$37.43 \$37.56  
\$48.64 \$46.34  
\$127.14 \$107.81  
\$239.29 \$195.62  
\$351.43 \$283.43  
\$463.57 \$371.24  
\$505.06 \$403.73  
\$575.72 \$459.05  
\$687.86 \$546.86

437

BMG - Cave Creek Southwest Gas  
Schedule C-1 G-25 (Medium)

\$15.00 \$90.00  
\$1.12143 \$0.76997

BMG Cost Components

SW Gas Cost Components

Margin Gas Cost Margin of Gas Base Cost Monthly Rate  
PGA Rate Adjustment

\$0.62357 \$0.49786 \$0.27211 \$0.37034 \$0.12752 \$0.00000

BMG - Cave Creek Southwest Gas

\$253.86 \$254.00  
\$505.06 \$426.48  
\$800.00 \$628.98  
\$1,136.43 \$859.97  
\$2,257.86 \$1,629.94  
\$3,379.29 \$2,399.91  
\$4,500.72 \$3,169.88  
\$5,622.15 \$3,939.85  
\$6,743.58 \$4,709.82

437

# Resort Tariff

Basic Service Charge  
per therm rate

BMG - Cave Creek Southwest Gas  
Schedule CRS-1 G-25 (Small)  
\$30.00 \$20.00  
\$1.12143 \$0.87810

BMG Cost Components SW Gas Cost Components  
Margin Gas Cost Margin Base Cost Monthly Rate  
of Gas PGA Rate Adjustment  
\$0.62357 \$0.49786 \$0.38024 \$0.37034 \$0.12752 \$0.00000

Bill Comparisons

30 therms  
100 therms  
200 therms  
300 therms  
400 therms  
437 therms  
500 therms  
600 therms

BMG - Cave Creek Southwest Gas  
\$63.64 \$46.34  
\$142.14 \$107.81  
\$254.29 \$195.62  
\$366.43 \$283.43  
\$478.57 \$371.24  
\$520.06 \$403.73  
\$590.72 \$459.05  
\$702.86 \$546.86

1999 avg. monthly usage

991

# Resort Tariff

Basic Service Charge  
per therm rate

BMG - Cave Creek Southwest Gas  
Schedule CRS-1 G-25 (Medium)  
\$30.00 \$90.00  
\$1.12143 \$0.76997

BMG Cost Components SW Gas Cost Components  
Margin Gas Cost Margin Base Cost Monthly Rate  
of Gas PGA Rate Adjustment  
\$0.62357 \$0.49786 \$0.27211 \$0.37034 \$0.12752 \$0.00000

Bill Comparisons

100 therms  
171 therms  
300 therms  
600 therms  
991 therms  
1500 therms  
3000 therms  
6000 therms  
9000 therms

BMG - Cave Creek Southwest Gas  
\$142.14 \$167.00  
\$221.76 \$221.66  
\$366.43 \$320.99  
\$702.86 \$551.98  
\$1,141.34 \$853.04  
\$1,712.15 \$1,244.96  
\$3,394.29 \$2,399.91  
\$6,758.58 \$4,709.82  
\$10,122.87 \$7,019.73

1999 avg. monthly usage

991



# Gas Air Conditioning Service Tariff

Basic Service Charge  
per therm rate

Bill Comparisons

200 therms  
400 therms  
523 therms  
750 therms  
1000 therms  
1009 therms  
1250 therms  
1500 therms

1999 avg. monthly usage

BMG - Cave Creek Southwest Gas  
Schedule GA-1 Schedule G-40

\$6.00 \$20.00  
\$0.58786 \$0.57399

BMG - Cave Creek Southwest Gas

\$123.57 \$134.80  
\$241.14 \$249.60  
\$313.45 \$320.20  
\$446.90 \$450.49  
\$593.86 \$593.99  
\$599.15 \$599.16  
\$740.83 \$737.49  
\$887.79 \$880.99

523

BMG Cost Components SW Gas Cost Components

Margin Gas Cost Margin Base Cost Monthly Rate  
of Gas PGA Rate Adjustment

\$0.09000 \$0.49786 \$0.07613 \$0.37034 \$0.12752 \$0.00000

# Cogeneration Tariff

Basic Service Charge  
per therm rate

BMG - Cave Creek Southwest Gas		BMG Cost Components SW Gas Cost Components			
Schedule CG-1	Schedule G-60	Margin	Gas Cost	Base Cost of Gas	Monthly Rate PGA Rate Adjustment
\$30.00	\$90.00				
\$0.55786	\$0.53713	\$0.06000	\$0.49786	\$0.08934	\$0.44779 \$0.00000 \$0.00000

## Bill Comparisons

100 therms  
1000 therms  
2000 therms  
3000 therms  
4174 therms  
5000 therms  
7000 therms  
9000 therms

BMG - Cave Creek	Southwest Gas
\$85.79	\$143.71
\$587.86	\$627.13
\$1,145.72	\$1,164.26
\$1,703.58	\$1,701.39
\$2,358.51	\$2,331.98
\$2,819.30	\$2,775.65
\$3,935.02	\$3,849.91
\$5,050.74	\$4,924.17

1999 avg. monthly usage

4174

Note: For the cogeneration tariff comparison, Southwest's actual gas cost value was inserted for Southwest's rates.  
The gas cost for this tariff is set differently than the gas cost for most other Southwest tariffs.

# Compressed Natural Gas Tariffs

Basic Service Charge  
per therm rate

BMG - Cave Creek Southwest Gas		BMG Cost Components SW Gas Cost Components			
Schedule CNG-1	Schedule G-55	Margin	Gas Cost	Base Cost of Gas	Monthly Rate PGA Rate Adjustment
\$6.00	\$8.00				
\$0.55786	\$0.58720	\$0.06000	\$0.49786	\$0.08934	\$0.37034 \$0.12752 \$0.00000

Bill Comparisons

	BMG - Cave Creek Southwest Gas
25 therms	\$19.95
50 therms	\$33.89
52 therms	\$35.01
75 therms	\$47.84
100 therms	\$61.79
200 therms	\$117.57
500 therms	\$284.93
1000 therms	\$563.86

Estimated Average Usage

52

Note: No usage information in 1999. CNG-1 Tariff approved 9-18-2000 (Decision Number 62890). Estimated usage is based upon Black Mountain's example of usage provided to Staff during the 2000 tariff approval proceeding.

## Schedule RGG-4

Charges	SWG	BMG-Page	BMG-Cave Creek
Establishment	(G-10)\$24	\$20	\$20
Expedited Service	\$32	----	----
All Other Schedules	\$30	----	----
Expedited	\$40	----	----
Re-Establishment	----	(1)	(1)
Re-Connection	----	\$30	\$30
After-hours	----	\$45	\$45
Service Calls Per Hour	----	\$30	\$30
After Hours	----	\$45	\$45
Meter Re-Read	\$10	\$25	\$25
Meter Test (per test)	\$25	----	----
" " (per hour)	----	\$25	\$25
Returned Check Charge	\$10	\$15	\$15
Late Charge	1.5% of	1.5%	1.5%
	Delinquent		
Field Collection Fee	\$20	----	----
Security deposit Residential	----	(2)	(2)
Security deposit Com.	----	(3)	(3)
Deferred Payment	----	----	1/5%

(1) Number of months off-system times monthly minimum charge (ACC Rule R14-2-403 (B))

(2) Two (2) times the average monthly bill (ACC R14-2-403 (B))

(3) Two and one-half (2 ½) times the average monthly bill (ACC R14-2-403 (B))

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL

Chairman

JIM IRVIN

Commissioner

MARC SPITZER

Commissioner

IN THE MATTER OF THE APPLICATION OF )  
SOUTHWEST GAS COMPANY FOR )  
APPROVAL OF ACQUISITION PLAN AND, IF )  
APPROPRIATE, WAIVER OF SELECTED )  
PROVISIONS OF THE AFFILIATE RULES )  
\_\_\_\_\_ )

DOCKET NO. G-01551A-02-0425

DIRECT

TESTIMONY

OF

ROBERT MILLER

UTILITIES CONSULTANT

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

DECEMBER 20, 2002

## TABLE OF CONTENTS

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## EXHIBITS

### Exhibit 1

Correspondence Regarding Black Mountain Gas Company 2002 Code Compliance Audit

**EXECUTIVE SUMMARY**  
**SOUTHWEST GAS CORPORATION**  
**DOCKET NO. G-01551A-02-0425**

Southwest Gas Corporation ("SWG") is seeking approval to acquire 100 percent of the stock of Black Mountain Gas Company ("BMG"). SWG also requests authority to subsequently transfer the assets and Certificate of Convenience and Necessity ("CC&N") to BMG to SWG.

Mr. Miller's direct testimony addresses the concerns of the Arizona Corporation Commission's ("Commission") Office of Pipeline Safety ("OPS" or "Pipeline Safety") relating to SWG's acquisition of BMG. Specifically, OPS is concerned with the use of contract locators and BMG's 2002 Code Compliance audit.

Mr. Miller recommends six conditions on the approval of SWG's application.

1     **INTRODUCTION**

2     **Q.     Please state your name and business address?**

3     A.     My name is Robert Miller. My business address is 2200 North Central Avenue, Phoenix,  
4             Arizona 85005.

5  
6     **Q.     What is your current occupation?**

7     A.     I am a Utilities Consultant in the Utilities Division's Office of Pipeline Safety ("Pipeline  
8             Safety"). I have been employed by the Arizona Corporation Commission ("Commission")  
9             since 1996.

10  
11    **Q.     Have you previously testified?**

12    A.     Yes. I have previously testified on behalf of Pipeline Safety in hearings.

13  
14    **Q.     WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

15    A.     The purpose of my testimony in this proceeding is to express and discuss the concerns of  
16             the Utilities Division's Office of Pipeline Safety staff relating to the acquisition of Black  
17             Mountain Gas Company ("BMG") by Southwest Gas Corporation ("SWG"). I also  
18             recommend six conditions for approval of SWG's application.

19  
20    **ANALYSIS**

21    **Q.     Does Pipeline Safety have any concerns with SWG's operations that would effect this**  
22             **merger?**

23    A.     Yes. It is SWG's policy to utilize contractors to locate most of its facilities. In the interest  
24             of public safety BMG has made the decision not to use contract locators. Based on the  
25             fact that the current BMG mapping is incomplete, as noted during the 2002 code  
26             compliance audit (see Exhibit 1, page 12). Pipeline Safety agrees with BMG's decision to



1 use full time regular employees for locate duties. These local employees are far more  
2 familiar with the BMG distribution system than an outside contract service could be. Until  
3 such time that BMG mapping has been completed and SWG is able to demonstrate the  
4 accuracy of these maps, Pipeline Safety would request that SWG continue to follow  
5 BMG's policy of not using contract personnel to locate underground gas pipelines within  
6 the BMG service area.

7  
8 **Q. Does Pipeline Safety have any concerns with the current operations of BMG?**

9 A. Yes. During BMG's 2002 Code Compliance Audit ("2002 Audit"), several probable non-  
10 compliance items were noted (see Exhibit 1, pages 1-6).

11  
12 **Q. Have these items been corrected by BMG?**

13 A. BMG has agreed in writing to make corrections to its procedures and to update and correct  
14 all mapping of its pipeline system. (See Exhibit 1, pages 7-16) The mapping is to be  
15 completed no later than May 1, 2003. SWG should complete all the items as stated in the  
16 Audit response provided to Pipeline Safety by BMG within the time frames as agreed  
17 upon by BMG and Pipeline Safety. (See Exhibit 1, page 17)

18  
19 **Q. Does Pipeline Safety have any other issues with BMG?**

20 A. Yes. During the 2002 Audit, the BMG emergency valve isolation plan was discussed.  
21 BMG stated that it would install additional valves in its system in order to better isolate  
22 and control the flow of gas in order to increase public safety and minimize the impact and  
23 potential risks of a broken or leaking pipeline to its customers. Pipeline Safety agrees  
24 with BMG and supports its efforts to maintain, improve and enhance public safety in its  
25 operation of the gas distribution system. SWG should follow through with BMG's plan to  
26 install these additional valves.

1  
2 **CONDITIONS FOR APPROVAL**

3 **Q. What conditions do you propose should the Commission approve SWG's**  
4 **application?**

5 **A.** I recommend the following conditions:

- 6
- 7 1. SWG shall continue to maintain the existing emergency isolation valves in all current
- 8 BMG service areas.
- 9
- 10 2. During the 2002 Code Compliance Audit, BMG stated that it was installing additional
- 11 emergency isolation valves (approximately 34). If at the time of the Stock transfer
- 12 from Xcel to SWG, BMG has not completed the installation of all currently planned
- 13 valves for the Cave Creek division, SWG shall complete the installation of those said
- 14 valves no later than May 1, 2003.
- 15
- 16 3. SWG shall not allow the acquisition to diminish staffing that would result in service
- 17 and/or safety degradation in either the current SWG or BMG service territories.
- 18
- 19 4. SWG shall continue to maintain fully operational local field offices in the cities of
- 20 Cave Creek and Page, as appropriate, to maintain the quality of service.
- 21
- 22 5. SWG shall continue BMG's current policy of not using contract personnel for the
- 23 performance of underground pipeline locating.
- 24
- 25 6. SWG or BMG shall complete all mapping of the BMG pipeline system no later than
- 26 May 1, 2003, as agreed to by BMG during its 2002 Code Compliance Audit.

1

2

**Q. Does this conclude your direct testimony?**

3

**A. Yes, it does.**

WILLIAM A. MUNDELL  
CHAIRMANJIM IRVIN  
COMMISSIONERMARC SPITZER  
COMMISSIONER

## ARIZONA CORPORATION COMMISSION

May 9, 2002

Mr. John Reiber  
President / CEO  
Black Mountain Gas Company  
P. O. Box 427  
Cave Creek, Arizona 85327

RE: 2002 CODE COMPLIANCE AUDIT

Dear Mr. Reiber:

The Arizona Corporation Commission's (Commission) Office of Pipeline Safety has the responsibility to enforce the Arizona Revised Statute Section 40-441. The Commission has adopted Title 49, Code of Federal Regulations, Parts 191, 192, 199, 40 and the Arizona Administrative Code R14-5-202 and R14-5-203 as the minimum standards for the transportation of natural and liquefied petroleum gas by pipeline. Black Mountain Gas Company is transporting natural and liquefied petroleum gas and is required to meet these minimum standards.

The Audit was conducted during April, 2002, by Robert Miller of the Commission's Office of Pipeline Safety and consisted of a review of the Operation and Maintenance Plan, Emergency Plan, Anti-Drug and Alcohol Prevention Programs a random review of records and a field inspection of pipeline facilities.

Enclosed are the probable noncompliances noted during this Audit. All probable noncompliances identified shall be applied to the entire pipeline system. Please provide a letter by June 9, 2002, showing compliance where possible or a schedule including dates for compliance.

Thank you for your continued interest in pipeline safety. Should you have any questions regarding this matter, you may contact Corky Hanson at (602) 542-3316.

Sincerely,

A handwritten signature in cursive script that reads "Terry Fronterhouse".

Terry Fronterhouse  
Chief of Pipeline Safety  
Pipeline Safety Section

TF:ss

Enclosures

BLACK MOUNTAIN GAS  
2002 CODE COMPLIANCE AUDIT  
PROBABLE NONCOMPLIANCES

1. NFPA 59 Chapter 1-10.1.3 Sources of Ignition.

Vehicles and other mobile equipment that constitutes a potential ignition source shall be prohibited within 50 feet of containers.

Finding:

Non exempt vehicles are allowed to be parked and or operated within 50 feet of the containers at Wahweap and Greenghavan facilities in Page (see Exhibit No. 1).

2. NFPA 59 Chapter 2-9.2 Loading and Unloading Facilities Spacing.

The filling pipe inlet terminal shall be located at least five feet behind vehicular barriers.

Finding:

Barriers have not been installed at the Wahweap or Greenghavan loading terminals (see Exhibit No. 2).

3. NFPA 59 Chapter 4-3.5 Valves and Accessories.

The connection into which the liquid or vapor is being transferred shall be equipped with a back flow check valve or an emergency shut off valve.

Finding:

At the time of this audit the vapor emergency cut off valve control line was inoperable at the Greenghavan facility (see Exhibit No. 3).

Note:

The cut off valve control line was repaired upon discovery during the audit.

4. Part 192.13 (c) General.

Written procedures shall be maintained and modified as appropriate.

Findings:

- Written leak survey procedures reference ASME G-11 for mobile natural gas leak surveys but fails to identify at which speed a mobile leak survey can be conducted (see Exhibit No. 4).
- Written procedures fail to require the use of protective clothing (nomex) in hazardous conditions except blowing gas (see Exhibit No. 5).
- Written boring procedures fail to provide adequate instruction to prevent damage to the pipeline being inserted into the bore (see Exhibit No. 6).

5. Part 192.16 Customer Notification.

Customers shall be notified if the customers buried piping is not maintained by the operator.

Findings:

- Written procedures had not been established at the time of the audit which require the notification of customers.
- Records were not available at the time of the audit demonstrating that customer notification was being conducted in the natural gas division.

6. Part 192.603 (b) General Provisions.

Each operator shall keep records necessary to administer the procedures established.

Findings:

- Training records were not available at the time of the audit to demonstrate that contract personnel, which are allowed to inspect their own work, had been trained to the operators manual of operations and maintenance (see exhibit No. 7).
- Regulator station construction records fail to identify which welding procedures were used and which welder performed the welding (see Exhibit No. 8).
- Training records were not available to demonstrate that all personnel were properly trained in the use of the company provided self-contained breathing apparatus.

7. Part 192.605 (a) Procedural Manual for Operations, Maintenance, and Emergencies.

A manual of written procedures shall be prepared and followed for conducting operation, maintenance activities and emergency response.

Findings:

- Leak survey personnel failed to follow written procedures, when documenting and classifying underground leaks. Combustible gas instrument (CGI) readings and a sketch showing bar hole location and CGI readings were not recorded following discovery of an underground leak (see Exhibit No. 9).
- Documentation was not available to demonstrate that Cave Creek management personnel had participated in the annual review of the emergency plan.
- The Cave Creek emergency response vehicle failed to have all equipment on board as required by the emergency vehicle inventory list. Emergency vehicle was not equipped with all required squeeze off tools and did not have a constant monitoring CGI on board.

8. Part 192.605 (b) (3) Procedural Manual for Operations, Maintenance, and Emergencies.

Making construction records, maps, and operating history available to appropriate operating personnel.

Finding:

Maps available at the time of the audit and used by locating, survey, construction and emergency response personnel fail to include all main and service lines (see Exhibit No. 10).

9. Part 192.616 Public Education.

Establish a continuing education program to enable customers, the general public, government organizations and excavators to recognize a gas pipeline emergency for the purpose of reporting it to the operator or appropriate public officials.

Finding:

Current public education program does include instruction on how to recognize an emergency for the purpose of reporting it to the operator or appropriate public officials.

10. Part 192.707 (a) Line Markers for Mains and Transmission Lines.

Line markers must be placed and maintained at each crossing of a public road and in Class 1 and Class 2 locations in sufficient numbers to identify the location of the pipeline.

Findings:

- Line markers were not installed at each crossing of a public roadway (see Exhibit No. 11).
- Line markers were not placed over the pipeline in sufficient numbers and spacing to determine the location of the pipeline (see Exhibit No. 11).

11. Part 192.707 (d) Line Markers for Mains and Transmission Lines.

The name and telephone number (including area code) of the operator must be written on each line marker.

Finding:

Area codes on line markers have not been changed to reflect the current area codes in effect at the time of the audit (see Exhibit No. 12).

12. Part 192.721 (b) Distribution Systems: Patrolling.

Mains in places or on structures where physical movement or external loading could cause failure must be patrolled.

Finding:

Patrolling failed to identify missing and or incorrect information on above ground mains installed under road bridges (see Exhibit No. 12).

13. Part 192.725 Test Requirements for Reinstating Service Lines.

Each disconnected service line must be tested in the same manner as a new service line, before being reinstated.

Finding:

Documentation provided during the audit failed to demonstrate that a repaired and reinstated service line had been tested as required (see Exhibit No. 13).



14. Arizona Administrative Code: R-14-5-202 (R).

Leakage survey records shall identify each pipeline surveyed.

Finding:

Leak survey documentation provided failed to adequately identify each area surveyed and each flame ionization (FI) unit and or each CGI used to conduct the leak survey.

Examples:

- Leak survey documentation provided failed to include the serial numbers of each FI and CGI units used to conduct the annual surveys (see Exhibit No. 10).
- Leak survey documentation provided failed to identify each pipeline surveyed. Survey maps fail to include all gas mains and service lines (see Exhibit No. 10).

15. Arizona Administrative Code: R-14-5-202 (F).

Any part of a pipeline transporting natural gas or other gas will not be constructed under a building.

Finding:

Buildings over pipelines were identified during the field portion of the audit at the following locations:

- 905 Cathedral Ave. Page, Arizona (see Exhibit No. 14).
- Residence at Elm and Gum Page, Arizona (see Exhibit No. 15).



CAVE CREEK ROAD • P.O. BOX 427 • CAVE CREEK, ARIZONA 85327

June 7, 2002

Mr. Terry Fronterhouse  
Chief of Pipeline Safety  
Pipeline Safety Section  
Arizona Corporation Commission

RECEIVED

JUN 10 2002

PIPELINE SAFETY  
ARIZONA CORPORATION COMMISSION

RE: 2002 CODE COMPLIANCE AUDIT

Dear Mr. Fronterhouse,

The following information is provided in response to probable non-compliances noted by your staff following the audit of Black Mountain Gas Company, which was conducted in April of 2002.

1. NFPA 59 Chapter 1-10.1.3 Sources of Ignition.

Vehicles and other mobile equipment that constitutes a potential ignition source shall be prohibited within 50 feet of containers.

Finding:

Non exempt vehicles are allowed to be parked and or operated within 50 feet of the containers at Wahweap and Greenthaven facilities in Page (see Exhibit No. 1).

Response:

Black Mountain Gas will post signs on the fencing at both the Wahweap and Greenthaven facilities which prohibits unauthorized vehicle parking within 50 feet of the facility. Additionally, BMG will work with the landowner to move the entry gate. It is anticipated that the above corrections will be made by August 30, 2002.

2. NFPA 59 Chapter 2-9.2 Loading and Unloading Facilities Spacing.

The filling pipe inlet terminal shall be located at least five feet behind vehicular barriers.

Finding:

Barriers have not been installed at the Wahweap or Greenghaven loading terminals (see Exhibit No. 2)

Response:

Black Mountain Gas will install concrete filled posts as vehicle barriers at the Wahweap and Greenghaven facilities. It is anticipated that the posts will be installed by August 30, 2002.

3. NFPA 59 Chapter 4-3.5 Valves and Accessories.

The connection into which the liquid or vapor is being transferred shall be equipped with a back flow check valve or an emergency shut off valve.

Finding:

At the time of this audit the vapor emergency cut off valve control line was inoperable at the Greenghaven facility (see Exhibit No. 3).

Note:

The cut off valve control line was repaired upon discovery during the audit.

Response:

Black Mountain Gas has repaired the vapor emergency cut off valve control line at the Greenghaven facility. The vapor emergency cutoff valve control lines will be inspected monthly at all bulk storage equipment locations. The monthly inspections will begin in June of 2002.

4. Part 192.13 (c) General.

Written procedures shall be maintained and modified as appropriate.

Findings:

- Written leak survey procedures reference ASME G-11 for mobile natural gas leak surveys but fails to identify at which speed a mobile leak survey can be conducted (see Exhibit No. 4).

Response:

Black Mountain Gas will develop written procedures that identify the speed at which a mobile leak survey can be conducted. The changes will be incorporated into the O & M Manual. The addition to the O & M Manual will be completed by August 5, 2002.

- Written procedures fail to require the use of protective clothing (nomex) in hazardous conditions except blowing gas (see Exhibit No. 5).

Response:

Black Mountain Gas will develop written procedures that identify the need to wear protective clothing in hazardous conditions which include blowing gas or any other time the employee in charge identifies that potential ignition of gas may occur. The changes will be incorporated into the O & M Manual. The addition to the O & M Manual will be completed by August 5, 2002.

- Written boring procedures fail to provide adequate instruction to prevent damage to the pipeline being inserted into the bore (see Exhibit No. 6).

Response:

Black Mountain Gas will develop written procedures that require inspection of the leading edge of any pipe that is inserted through a bore. If damage is identified, the damaged pipe will be removed or abandoned, necessary action taken to eliminate additional damage and a new pipe installed. The changes will be incorporated into the Construction Manual. The addition to the Construction Manual will be completed by August 5, 2002.

5. Part 192.16 Customer Notification.

Customers shall be notified if the customers buried piping is not maintained by the operator

Findings:

- Written procedures had not been established at the time of the audit which require the notification of customers.
- Records were not available at the time of the audit demonstrating that customer notification was being conducted in the natural gas division.

Response:

Black Mountain gas will complete a mailing to all customers of record in the Cave Creek Division that notifies the customer that buried piping downstream of the meter is not maintained by Black Mountain Gas Company. The mailing will be completed by August 30, 2002. Additionally, this notification will be provided to customers when they apply for service with Black Mountain Gas. Documentation that notification was given to a customer by personal delivery or by mailing will be added to the Application for Service.

6. Part 192.603 (b) General Provisions.

Each operator shall keep records necessary to administer the procedures established.

Findings:

- Training records were not available at the time of the audit to demonstrate that contract personnel, which are allowed to inspect their own work, had been trained to the operators manual of operations and maintenance (see exhibit No. 7).

Response:

Following revision of the Black Mountain manuals to incorporate changes identified in this document, training of contract personnel will be completed. Contractor training will be completed by August 30, 2002.

- Regulator station construction records fail to identify which welding procedures were used and which welder performed the welding (see Exhibit No. 8).

Response:

The records identified in Exhibit #8 will be amended to include the welding procedures used and to identify the welder who performed the work. Forms utilized to document work when welding is completed as part of system construction or maintenance will be modified to document the welding procedure used and the welder.

6. Part 192.603 (b) General Provisions. (continued)

Each operator shall keep records necessary to administer the procedures established.  
(continued)

Findings: (continued)

- Training records were not available to demonstrate that all personnel were properly trained in the use of the company provided self-contained breathing apparatus.

Response:

All employees who may be required to use the company provided self-contained breathing apparatus will be re-trained and documentation of the training filed. The training will be completed before August 30, 2002.

7. Part 192.605 (a) Procedural Manual for Operations, Maintenance, and Emergencies.

A manual of written procedures shall be prepared and followed for conducting operation, maintenance activities and emergency response.

Findings:

- Leak survey personnel failed to follow written procedures, when documenting and classifying underground leaks. Combustible gas instrument (CGI) readings and a sketch showing bar hole location and CGI readings were not recorded following discovery of an underground leak (see Exhibit No. 9).

Response:

All employees or contractors who may be involved in leak survey activities will be trained to follow the procedures as documented in the O & M Manual. The training will be completed prior to the start of the 2002 leak survey (July 1, 2002).

- Documentation was not available to demonstrate that Cave Creek management personnel had participated in the annual review of the emergency plan.

Response:

All employees, including management who may be involved with use of the Emergency Plan will complete training. The training will be completed by July 1, 2002.

7. Part 192.605 (a) Procedural Manual for Operations, Maintenance, and Emergencies.  
(continued)

A manual of written procedures shall be prepared and followed for conducting operation, maintenance activities and emergency response. (continued)

Findings: (continued)

- The Cave Creek emergency response vehicle failed to have all equipment on board as required by the emergency vehicle inventory list. Emergency vehicle was not equipped with all required squeeze off tools and did not have a constant monitoring CGI on board.

Response:

Prior to June 28, 2002, provisions will be made to have all equipment on board the Cave Creek emergency response vehicle as required by the emergency vehicle inventory list.

8. Part 192.605 (b) (3) Procedural Manual for Operations, Maintenance, and Emergencies.

Making construction records, maps, and operating history available to appropriate operating personnel.

Finding:

Maps available at the time of the audit and used by locating, survey, construction and emergency response personnel fail to include all main and service lines (see Exhibit No. 10).

Response:

As future leak surveys are conducted, Black Mountain Gas will review and/or modify documents to ensure that the locations of all gas lines are documented as required for use during locating, survey, construction and emergency response activities. The company will ensure that the information necessary is made available to employees completing the above activities. It is anticipated that it may require up to 5 years to complete the review and documentation.

9. Part 192.616 Public Education.

Establish a continuing education program to enable customers, the general public, government organizations and excavators to recognize a gas pipeline emergency for the purpose of reporting it to the operator or appropriate public officials.

Finding:

Current public education program does include instruction on how to recognize an emergency for the purpose of reporting it to the operator or appropriate public officials.

Response:

Black Mountain Gas will complete a mailing to all customers of record in the Cave Creek Division that notifies the customer of how to recognize emergency conditions. The mailing will be completed by August 30, 2002. Additionally, this notification will be provided to customers when they apply for service with Black Mountain Gas. Documentation that notification was given to a customer by personal delivery or by mailing will be added to the Application for Service. The general public in the service area will be informed through advertising in local newspapers; to be completed by August 30, 2002.

10. Part 192.707 (a) Line Markers for Mains and Transmission Lines.

Line markers must be placed and maintained at each crossing of a public road and in Class 1 and Class 2 locations in sufficient numbers to identify the location of the pipeline.

Findings:

- Line markers were not installed at each crossing of a public roadway (see Exhibit No. 11).

Response:

A review of the pipeline markers will be made by Black Mountain Gas employees and markers installed as necessary. The inspection will be complete by September 30, 2002.

- Line markers were not placed over the pipeline in sufficient numbers and spacing to determine the location of the pipeline (see Exhibit No. 11).

Response:

A review of the pipeline markers will be made by Black Mountain Gas employees and markers installed as necessary. The inspection will be complete by September 30, 2002.



11. Part 192.707 (d) Line Markers for Mains and Transmission Lines.

The name and telephone number (including area code) of the operator must be written on each line marker.

Finding:

Area codes on line markers have not been changed to reflect the current area codes in effect at the time of the audit (see Exhibit No. 12).

Response:

A review of the pipeline markers will be made by Black Mountain Gas employees and area coded modified as necessary. The inspection will be complete by September 30, 2002.

12. Part 192.721 (b) Distribution Systems: Patrolling.

Mains in places or on structures where physical movement or external loading could cause failure must be patrolled.

Finding:

Patrolling failed to identify missing and or incorrect information on above ground mains installed under road bridges (see Exhibit No. 12).

Response:

A review of the above ground mains installed under road bridges was completed April 18, 2002 and missing information provided or incorrect information corrected.

13. Part 192.725 Test Requirements for Reinstating Service Lines.

Each disconnected service line must be tested in the same manner as a new service line, before being reinstated.

Finding:

Documentation provided during the audit failed to demonstrate that a repaired and reinstated service line had been tested as required (see Exhibit No. 13).

Response:

The service line identified in Exhibit 13 was excavated and air tested on May 3, 2002.

14. Arizona Administrative Code: R-14-5-202 (R).

Leakage survey records shall identify each pipeline surveyed

Finding:

Leak survey documentation provided failed to adequately identify each area surveyed and each flame ionization (FI) unit and or each CGI used to conduct the leak survey.

Examples:

- Leak survey documentation provided failed to include the serial numbers of each FI and CGI units used to conduct the annual surveys (see Exhibit No. 10).
- Leak survey documentation provided failed to identify each pipeline surveyed. Survey maps fail to include all gas mains and service lines (see Exhibit No. 10).

Response:

As future leak surveys are conducted, the leak survey documentation will identify each area surveyed and each flame ionization (FI) unit or CGI used to conduct the survey. Additionally, as future leak surveys are conducted, Black Mountain Gas will review and/or modify documents to ensure that the locations of all gas lines are documented. It is anticipated that up to 5 years to complete the review and documentation.

15. Arizona Administrative Code: R-14-5-202 (F).

Any part of a pipeline transporting natural gas or other gas will not be constructed under a building.

Finding:

Buildings over pipelines were identified during the field portion of the audit at the following locations:

- 905 Cathedral Ave. Page, Arizona (see Exhibit No. 14).
- Residence at Elm and Gum Page, Arizona (see Exhibit No. 15).

Response:

Black Mountain Gas surveyed all sheds/buildings in the Page area and identified two sites in addition to those identified in the audit. The disposition of each of the four sites is as follows:

905 Cathedral – Building has been moved.

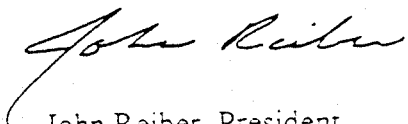
Elm & Gum – Used as storage shed only; not for occupancy

#2 Red Mesa – Main will require cut-off or re-route will be completed by August 30, 2002.

San Francisco & Cameron – Main will be cut-off by August 30, 2002

Should you or your staff have any questions regarding the provided responses, please contact me at (480) 488-3402 X213 or Mr. Saul Carrasco, Gas Operations Manager at (480) 488-3402 X204.

Sincerely,

A handwritten signature in cursive script, appearing to read "John Reiber".

John Reiber, President  
Black Mountain Gas Company

CC: Saul Carrasco  
Gail Robinson  
Mark Nolan  
Ben Sherman

WILLIAM A. MUNDALL  
CHAIRMAN  
JIM IRVIN  
COMMISSIONER  
MARC SPITZER  
COMMISSIONER



BRIAN C. McNEIL  
EXECUTIVE SECRETARY

## ARIZONA CORPORATION COMMISSION

June 26, 2002

## CERTIFIED MAIL

Mr. John Reiber  
President: CEO  
Black Mountain Gas Company  
P.O. Box 427  
Cave Creek, Arizona 85327

RE: 2002 CODE COMPLIANCE AUDIT

Dear Mr. Reiber:

The Arizona Corporation Commission's Pipeline Safety Section has received your response dated June 7, 2002, in regards to the 2002 Code Compliance Audit. Staff's review finds your response to the 15 probable noncompliance items to be acceptable with the exception of the following item.

Item No. 8, 192.605 (b) (3)

In your response you state that it may take up to five years to complete the mapping. Staff finds this to be an excessive amount of time. Mapping in areas where required leak surveys are scheduled shall be completed prior to a survey being conducted. All remaining mapping shall be completed no later than May 1, 2003.

Thank you for your continued interest in pipeline safety. Should you have any questions regarding this matter, you may contact Corky Hanson at (602) 542-3316.

Sincerely,

A handwritten signature in cursive script that reads "Terry Fronterhouse".

Terry Fronterhouse  
Chief of Pipeline Safety  
Pipeline Safety Section

TFrem.